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TRANSCRIPT OF RECORD

SUPREME COURT OF THE UNITED STATES

OCTOBER TERM, 1929

No. 402

THE UNITED STATES OF AMERICA, PETITIONER

vs.

GUARANTY TRUST COMPANY OF NEW YORK ET AL.

ON WRIT OF CERTIORARI TO THE UNITED STATES CIRCUIT COURT OF APPEALS FOR THE EIGHTH CIRCUIT

PETITION FOR CERTIORARI FILED SEPTEMBER 17, 1929
CERTIORARI GRANTED OCTOBER 21, 1929

SUPREME COURT OF THE UNITED STATES

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A [Caption omitted.]

1 In United States District Court

District of Minnesota, Fourth Division

MINNEAPOLIS STEEL & MACHINERY COMPANY, COMPLAINANT
vs.
MINNEAPOLIS & ST. LOUIS RAILROAD COMPANY, DEFENDANT

Bill of complaint

Filed July 26, 1923

Comes now the above-named complainant and for itself and all others similarly situated who may desore to become complainants files this its bill of complaint asking for the appointment of a receiver or receivers for the Minneapolis & St. Louis Railroad Company, and states, alleges, and pleads, as follows:

(Paragraphs 1 to 9 omitted.)

10

That defendant is insolvent and unable to pay its debts already due and will be unable to meet its obligations immediately falling due. That it has no funds on hand at its disposal to meet its immediate and pressing needs and is without credit whereby it can borrow money for such purposes. That it is now indebted to the complainant in excess of the sum of $15,000 for labor performed and for goods, wares, and merchandise which sum is now past due and owing.

(Paragraphs 11 to 18 omitted.)

MINNEAPOLIS STEEL & MACHINERY COMPANY,
By EDWIN A. MERRILL,
President.
COBB, WHEELWRIGHT, HOKE & BENSON,
Counsel.
ALBERT C. COBB & JOHN C. BENSON,
Solicitors for Complainant.

2 [*Duly sworn to by Edwin A. Merrill; jurat omitted in printing.*]
(*All in italics.*)
[File indorsement omitted.]

In United States District Court

Answer

Title omitted.

Filed July 26, 1923

The defendant in the above-entitled cause enters its appearance therein and for answer to the petition of said complainant or unto

so much and such parts thereof as the defendant is advised it is necessary or material to answer, says:

PAR. 1. That it admits the statements and allegations in said petition contained, and waives the service of all notices herein.

PAR. 2. That it joins in the prayer of said petition and, to the end that its duties and obligations to the public as a common carrier may not be interfered with, and that the rights and interests of all its creditors be subserved and protected, asks that a receiver be forthwith appointed to take immediate charge and possession of the railroad, property, and business in said petition referred to or mentioned, with full power and authority to manage, operate, preserve, protect, and control the same and otherwise have and exercise
3 all the powers and perform and discharge all the duties granted to or imposed upon receivers in like or similar cases; that, upon the final hearing of this cause, the court will make and enter such decree or decrees, with respect to the business and property of this defendant and the disposition thereof, as may be just and equitable to all concerned; that the court will cause all rights and claims in equity of persons interested in said railroad, business, and property and the operation thereof to be ascertained, determined, and defined; and that the proceeds arising from any sale or sales or other disposition of said property and business be applied under the orders or decrees of the court according to the rights, interests, and equities of the persons therein interested.

THE MINNEAPOLIS & ST. PAUL RAILROAD COMPANY,
By DONALD EVANS, *Its Solicitor.*

[File indorsement omitted.]

In United States District Court

Report of Howard S. Abbott, special master, upon the claims of the United States of America et al.

Filed Aug. 13, 1928

To the honorable the District Court for the district and division and in the cause above entitled.

On the 20th day of August, 1923, an order was made and entered in the above-entitled cause by Hon. Wilbur F. Booth, one of the judges of this court fixing the time within which claims against the Minneapolis & St. Louis Railroad Company should be filed with the undersigned as special master and further providing for hearings upon said claims as filed and for a report upon the claims, accounts, and demands which should be so filed and heard; that notice for the filing of claims was published by the undersigned as required by said order of August 20, 1923. The report of the undersigned with reference to the publication of said notice as required by the order is on file and of record with the clerk of said court, and to which,

as well as the order of August 20, 1923, reference is hereby made for greater particularity in respect to the manner of filing claims and their determination by the undersigned as special master. That the time for filing was subsequently extended by order of this court to and including the first day of March, 1924.

4 Statement of case with findings of fact and conclusions

I would find that pursuant to the directions of said notice and under the authority of said orders and of the special orders entered later the claimants, as hereinafter stated, duly filed their claims with the undersigned, based upon the alleged indebtedness or liabilities as fully set forth in said claims and as hereinafter stated. That a hearing upon said claims was fixed for January 25, 1927, and notice thereof was duly mailed to counsel for the claimants and the parties to this cause. That on application of counsel for the various trustees, parties to this cause, the hearing upon said claims was continued until November 28, 1927. That on said day the hearing was further adjourned to February 7, 1928, on application of counsel for the various trustees parties to this cause. On February 7, 1928, the hearing on said claims was again continued on application duly made by counsel for the United States of America to March 7, 1928; on that day it was again continued on motion of counsel for the United States to April 4, 1928, and on that day hearing upon the claims was again continued upon motion of counsel for the United States and until May 21, 1928, at the hour of ten o'clock in the forenoon. At this time, pursuant to adjournment and also to notice duly given, a hearing was had in Minneapolis, Minnesota, in courtroom No. 2 at the hour of ten o'clock in the forenoon on the claims hereinafter listed. That a record and transcript of proceedings had before me at said time and place to which is attached a copy of the notice of hearing as thus given with the affidavit of service thereof is herewith filed by me under separate cover and with a certificate of its accuracy and completeness. Said record and transcript recites in full the appearance of counsel for the parties and claimants on May 21, 1928, and the proceedings then had and now upon the files and record in this cause and said claims with papers attached as filed with me and the answers and objections thereto, if any, as submitted by the receiver or any of the parties in this cause, and the contentions and arguments of counsel or other parties upon the various questions suggested and raised I herewith submit my findings of fact and conclusions of law.

I would find that five claims were heard and considered by me on said May 21, 1928, and as follows:

My No. 1827, United States of America, claimant.

My No. 2700, United States of America, claimant.

My No. 3268, James C. Davis, Director General of Railroads, claimant.

5 My No. 4153, United States Collector of Internal Revenue for the District of Minnesota, claimant.
My No. 4186, United States of America, claimant.

Claim No. 1827

I would find the facts relating to this claim to be as follows: November 14, 1923, in the District Court of the United States for the Northern District of Illinois a certain cause was pending in the District Court No. 8120 wherein the United States of America was complainant and the Minneapolis & St. Louis Railroad Company was defendant. The charge in the case being a violation of the quarantine act by said Minneapolis & St. Louis Railroad Company on April 2, 1921. To this charge a plea of guilty was entered and a fine of $100.00 was imposed, due and payable as of November 14, 1923. The answer of the receiver admitted the indebtedness and the facts as stated in the proof of claim filed with the master. A preference and priority was asserted with respect to the payment of this claim by the claimant, and to which assertion of priority in payment and to the claim in question H. H. Sheriff duly filed an objection and answer and the Guaranty Trust Company on behalf of itself and other trustees also filed an objection and answer to the claim of preference in payment. I would find that there is due and owing to the United States of America from the Minneapolis & St. Louis Railroad Company on account of the fine so imposed the sum of $100.00.

Claim No. 2700—Filed December 26, 1923

The proof of claim for this number was filed with the master on December 26, 1923, and asserted an indebtedness to the United States of a total of $3,411,673.51, exclusive of interest. The claimant asserted a priority and preference with respect to the payment of this claim, based upon section 3466, Revised Statutes, United States, section 6372, U. S. Compiled Statutes. This total comprised the following items:

(1) A promissory note of the Minneapolis & St. Louis Railroad Company for $1,382,000.00, dated April 2, 1921, with interest at the rate of 6% per annum, payable semiannually on the 1st day of April and October in each calendar year until full payment of the principal sum. This note was given by the carrier to the United
6 States of America pursuant to the provisions of section 210 of the transportation act of 1920, as amended, and certificate No. 81 of the Interstate Commerce Commission and represented a loan made by the United States to the railroad company of the face of the note for the purpose of paying a mortgage for $1,382,000 known as the Pacific Extension Mortgage of the Minneapolis & St. Louis Railroad Company theretofore duly executed by said company and maturing on April 1, 1921. This note was secured by a deposit of collateral by the railroad company of $2,377,000.00 principal

amount of the refunding and extension mortgage, 50 year, Series "A," 5% gold bonds of the Minneapolis & St. Louis, dated January 1, 1912, and due in 1962. Interest upon this note was duly paid up to and including the interest payment on April 1, 1923. I would find there is due and owing to the United States of America from the Minneapolis & St. Louis on account of the indebtedness evidenced by said promissory note as follows: The principal sum of $1,382,000.00

(2) Item 2 of the proof of claim was based on a promissory note issued by the National Railway Service Corporation, as maker to the United States, or order of the Secretary of the Treasury, as payee, in the principal amount of $386,190.00 (since reduced), dated July 1, 1921, due June 1, 1936, with interest at the rate of 6% per annum payable semiannually on the 1st days of June and December in each calendar year and until payment of the principal sum, bearing the unrestricted endorsement and guaranty of the Minneapolis & St. Louis Railroad Company as to principal and interest. The promissory note represented a loan to the National Railway Service Corporation for the benefit of the carrier pursuant to the provisions of section 210 of the transportation act of 1920, as amended. The note was secured by deferred lien certificates of the corporation in the principal amount of $386,190.00 (since reduced), dated June 1, 1921, due June 1, 1936, with interest at the rate of 6% per annum, payable semiannually on the 1st days of June and December in each calendar year and until payment of said principal sum and by other collateral hereinafter described. These deferred lien certificates were issued pursuant to the provisions of contract No. 2 entered into by the carrier under equipment trust agreement, Series "A," lease basis, dated June 1, 1921, executed by the National Railway Service Corporation to the Bankers Trust Company of New York as trustee.

This obligation was issued and the indebtedness arose in connection with the purchase of engine equipment under cir-
7 cumstances briefly stated as follows (Government's Exhibit No. 4): Additional engine equipment was necessary and desired in connection with the operation of the Minneapolis & St. Louis Railroad. Arrangements for the purchase of such equipment were made by the Director General of Railroads in connection with the National Railway Service Corporation, the Bankers Trust Company of New York, as trustee, and the Minneapolis & St. Louis Railroad Company. Fifteen engines were purchased, the original cost of which was approximately $965,475.00. The payment of this amount, with interest was distributed over a period of fifteen years. The principal with accrued interest upon partial payments to the date of maturity was computed in the amount of $1,592,250.00, which with an initial payment of $1,783.75 made the total cost of the equipment $1,593,033.75 including interest. The total principal and interest sum of $1,592,250.00 was then divided into equal rental note payments, so-called, covering the period of fifteen years, payable in semiannual instalments of $53,075.00 due May 20th and November

20th of each year. These rental notes, so-called, were duly executed by the Minneapolis & St. Louis Railroad Company in favor of the National Railway Service Corporation. Of the principal required to pay the original cost of $965,475.00 the United States of America advanced to the National Railway Service Corporation 40% of the sum, or $386,190.00 (since reduced), and the remainder or 60% was raised by the National Railway Service Corporation from private sources. To secure this advance of $386,190.00 the National Railway Service Corporation gave its note to the Secretary of the Treasury for that amount (this note is the one involved in item No. 2 of Government's claim No. 2700). As additional security this note was duly endorsed and guaranteed by the Minneapolis & St. Louis Railroad Company. It was also secured by a second lien upon $1,500,000.00 of the Minneapolis & St. Louis Refunding and Extension 5% bonds previously deposited as collateral security for the payment of the two notes dated May 27, 1922, and April 1, 1923, for $625,000.00 each and which constitute items No. 3 and No. 4 of the Government's claim No. 2700. In connection with the financing of the purchase by the National Railway Service Corporation it issued, through the Bankers Trust Company of New York, as trustee, trust certificates to the amount of 60% of the total trust notes as prior lien certificates, and the balance, or 40%, known as deferred lien certificates. With the Government was deposited as additional security for the note of $386,190.00, the 40% of deferred lien certificates.

8 The amount of the rental notes due the National Railway Service Corporation from the Minneapolis & St. Louis and outstanding on July 26, 1923, was $1,379,950.00, and the amount outstanding on September 30, 1926, was $1,061,500.00. These notes were secured by an equipment lease or trust agreement of the usual type covering fifteen Mikado type locomotives, Class M–1–46 (3), bearing Minneapolis & St. Louis numbers 620 to 634 inclusive.

The record discloses that this equipment trust contract was duly adopted by the receiver as his own and further that by order of court all payments falling due from time to time have been promptly made by the receiver on behalf of the railroad company and that at this time there has been no default in the payment of any of said rental notes falling due May 20th and November 20th of each year. That the note of $386,190.00 (since reduced) was one given directly by the National Railway Service Corporation to the United States of America and that the liability of the Minneapolis & St. Louis Railroad Company thereon is that of an endorser only. That no notice of any failure or default with respect to the same on the part of the National Railway Service Corporation its maker has been given to the Minneapolis & St. Louis or any one authorized to receive the same on its behalf. And further, the note of $386,190.00 is by its express terms not yet due and there has been no default in the performance of any of the conditions thereof by the National Railway Service Corporation or by the Minneapolis & St. Louis as endorser. I would

therefore find that there is nothing due at this time to the United States of America from the Minneapolis & St. Louis Railroad Company or its receiver with respect to the obligation and the transactions stated in detail in item No. 2 of the proof of chaim—i. e., the note of the National Railway Service Corporation in favor of the Secretary of the Treasury for $386,190.00 (since reduced).

(3) Item 3 (Government's Exhibit No. 1) of this claim is a promissory note for $625,000.00 given to the Director General of Railroads by the Minneapolis & St. Louis Railroad Company, dated May 27, 1922, due March 1, 1930, and with interest at the rate of 6% per annum, payable semiannually on the 1st days of April and October in each calendar year, until payment of said principal sum. This obligation represents indebtedness incurred in the operation of the Minneapolis & St. Louis Railroad Company to the United States of America due at the termination of Federal control
9 and which was funded pursuant to the provisions of section 207 of the transportation act, 1920. This note was secured by a deposit of collateral of $1,500,000.00, principal amount of the refunding and extension mortgage, 50 year, Series "A," 5% gold bonds of the Minneapolis & St. Louis Railroad Company, dated January 1, 1912, and due in 1962. I would find that the interest upon this note has been paid up to and including the installment of interest due on April 1, 1923. I would also find there is due to the United States of America from the Minneapolis & St. Louis on account of the indebtedness represented by this note the principal sum of $625,000.00.

(4) Item 4 (Government's Exhibit No. 2) of this claim is represented by a promissory note for $625,000.00, dated April 1, 1923, due on demand, given to the Director General of Railroads by the Minneapolis & St. Louis Railroad Company and with interest at the rate of 6% per annum, payable semiannually on the 1st days of April and October, in each calendar year and until payment of said principal sum. This note represents indebtedness incurred in the operation of the Minneapolis & St. Louis, to the United States of America, due at the termination of Federal control and funded pursuant to the provisions of section 207 of the transportation act of 1920. This note was secured by a deposit of collateral, junior to the note referred to in the preceding paragraph of $1,500,000.00 principal amount refunding and extension mortgage, 50 year, Series "A," 5% gold bonds of the Minneapolis & St. Louis Railroad Company, dated January, 1912, and due in 1962. The interest upon said note has been paid in full up to and including April 1, 1923. I would find there is now due and owing to the United States of America from the Minneapolis & St. Louis Railroad Company the principal sum of $625,000.00.

(5) Item 5 (Government's Exhibit No. 6) of this proof of claim is based upon twelve promissory notes for $33,600.00 each, given by the Minneapolis & St. Louis to the Director General of Railroads

and in the total sum of $403,200.00, dated January 15, 1920, and maturing successively on the 15th days of January, 1924 to 1935, inclusive, with interest at the rate of 6% per annum, payable semi-annually on the 15th days of January and July in each calendar year and until full payment of the principal sum. The promissory notes given are based upon the purchase of equipment allotted to the carrier, the Minneapolis & St. Louis, during Federal control pursuant to the provisions of the act of Congress approved November 10 19, 1919, issued under equipment trust agreement, dated January 15, 1920. The details respecting the purchase of this equipment are briefly as follows:

Director General of Railroads equipment trust notes, in the principal sum of $1,512,000.00, dated January 15, 1920, maturing at the annual rate of $100,800.00, payable January 15th, of each year. There were outstanding July 26, 1923, $1,209,600.00 and on September 30, 1926, $907,200.00. The interest for this series was fixed at 6% per annum payable January and July 15th, of each year. The initial payments in connection with this contract were $6,282.19, making a total cost for the series of $1,518,282.19, exclusive of interest. The issue was secured by equipment lease, to the Guaranty Trust Company of New York as trustee, of three hundred 40-ton steel underframe box cars, bearing Minneapolis & St. Louis numbers, commencing at No. 22,000 and continuing, even numbers only, consecutively to No. 22,598, inclusive, and two hundred fifty 50-ton composite gondola cars, bearing Minneapolis & St. Louis numbers, commencing at No. 27,001 and continuing, odd numbers only, consecutively to No. 27,499, both inclusive.

It appears from the record that the equipment trust contract in question was adopted by the receiver as his own and that by direct and express orders of the court in this cause the interest payments and the principal notes as they matured have been paid by the receiver for and on behalf of the Minneapolis & St. Louis, and that at this time there has been no default in the payment of the principal of said notes as they became due, nor in the payment of the interest upon the unmatured obligations. That none of the notes of this series remaining unpaid are by their express terms due and that there has been no default in the conditions of the obligations themselves or of the equipment trust agreement in connection with which they were issued. I would therefore find that there is nothing due at this time to the United States of America from the Minneapolis & St. Louis Railroad Company or its receiver with respect to the obligations and transactions stated in detail in item No. 5 of the proof of claim in claim my No. 2700.

Claim No. 3268

This claim was filed by the Director General of Railroads for the sum of $85.35 on account of the Minneapolis & St. Louis Railroad Company's proportion of loss and damage claims in connection

11 with the interchange of traffic between the Northern Pacific Railway Company and the Minneapolis & St. Louis Railroad Company. That the receiver in his answer to this claim admitted a liability and indebtedness in the amount as claimed, and I would therefore find there is due and owing to the Director General of Railroads, United States Railroad Administration, the sum of $85.35. A priority and preference was alleged with respect to the payment of this claim under section 3466 of the Revised Statutes of the United States.

Claim No. 4153

Claim No. 4153 was filed for and on behalf of the United States by the collector of internal revenue of the State of Minnesota, alleging an overpayment in tax adjustments under section 253 of the revenue act for 1921 as between the Minneapolis & St. Louis and the United States of America. Preference with respect to the payment of this claim was alleged by the claimant. The record discloses the fact that the claimant had received an excess of moneys from the Minneapolis & St. Louis Railroad Company rather than a deficiency. That the amount of such excess had been repaid to the Minneapolis & St. Louis and that the claim had been by reason of such adjustment and settlement withdrawn. I would therefore find that there is nothing due the United States of America with respect to the matters set forth in claim No. 4153.

Claim No. 4186

This claim is based upon an alleged indebtedness to the United States of America as evidenced by a determination of the Interstate Commerce Commission under date of April 14, 1924, finance docket No. 632, and in the sum of $292,022.23. (Government's Exhibit No. 7.) It represents the alleged overpayment by the Government in connection with the adjustment of accounts with respect to the guaranty under section 209 of the transportation act of 1920. It appears that an aggregate amount of $2,150,000.00 was certified for payment as advances under paragraph "h" and an aggregate amount of $490,000.00 was certified as a partial payment under paragraph "g" of section 209, as amended by section 212. The total amount found by the commission as necessary to make good the guaranty of section 209 of the transportation act was $2,347,977.77. A total of $2,640,000.00 having been certified for payment and paid, an overpayment in the amount of this claim resulted. It appears from the record that the formula fol-

12 lowed by the commission in arriving at the amount of the guaranty was disputed by the Minneapolis & St. Louis and its receiver and that litigation is pending for the purpose of readjustment of this formula or basis in accordance with the views of the railroad company. The correctness of the adjustment as

made by the Interstate Commerce Commission is a question which the master considers as not coming within his jurisdiction. It was agreed at the time of the hearing upon this claim that the master should pass only upon the question of priority of payment as asserted by the Government, the amount of the claim so passed upon to be that as ultimately determined by the litigation referred to. The amount so alleged—namely, $292,022.23—not being admitted by the Minneapolis & St. Louis nor proved except through the introduction of Government's Exhibit No. 7, that being the official determination of the Interstate Commerce Commission upon the adjustment of accounts under the Government guaranty of sections 209 and 212.

I would also find that the construction of the Minneapolis & St. Louis Railroad Company (Minneapolis Company No. 1) was originally authorized in 1853 by an act of Legislature of the State of Minnesota. That on or about February 1, 1877, this company under lawful authority duly executed and delivered its mortgage or deed of trust dated February 1, 1877, to the Farmers' Loan & Trust Company of New York as trustee, wherein and whereby the Minneapolis Company granted, sold, conveyed, transferred, pledged, and set over to Farmers' Loan & Trust Company of New York as trustee the line of railway and properties therein described to secure an issue of $1,100,000.00 of first mortgage bonds, $950,000.00 of which are now outstanding and unpaid and constitute the valid, binding, and legal obligations of the present Minneapolis & St. Louis Railroad Company. That said mortgage was at that time duly recorded as required by law in each county in which the lines of railway and other properties of the mortgagor covered by said mortgage were situated or located and that by virtue of such recordation under statutory law said mortgage became a lien upon all the properties so mortgaged and that said lien continued to and still exists with full force and effect. This mortgage is commonly referred to as the Merriam Junction-Albert Lea mortgage.

In April, 1881, the Minneapolis & St. Louis, Minneapolis & Duluth, Fort Dodge & Fort Ridgely, and the Minnesota & Iowa Southern Railroad Companies consolidated under authority of
13 an act of Legislature of the State of Minnesota passed in 1881, forming Minneapolis Company No. 2, which existed from 1881 to the latter part of 1894. In 1888 this company defaulted in its obligations, passed into the hands of a receiver appointed by the Hennepin County District Court for the State of Minnesota, which receivership continued until the autumn of 1894, when a sale of the road was had and which ultimately passed into the hands of a reorganized company, Minneapolis Company No. 3, a new corporation.

I would also find that on or about November 2, 1894, the Minneapolis & St. Louis Railroad Company (Minneapolis Company No.

3), the new corporation, under lawful authority duly executed and delivered its mortgage or deed of trust to the Central Trust Company of New York as trustee (the New York Trust Company of New York, the present trustee), wherein and whereby the Minneapolis Company granted, sold, conveyed, transferred, pledged, and set over to said Central Trust Company of New York as trustee the line of railway and properties therein described to secure an issue of first consolidated mortgage gold bonds in the principal sum of $10,000,000.00, of which $5,282,000.00 were so issued and are now outstanding and unpaid and constitute the valid, binding, and legal obligations of the present Minneapolis & St. Louis Railroad Company. That said mortgage was at that time duly recorded as required by law in each county in which the lines of railway and other properties of the mortgagor covered by said mortgage were situated or located and that by virtue of such recordation under statutory law said mortgage became a lien upon all the properties so mortgaged and that said lien continued to and still exists with full force and effect.

February 1, 1895, Minneapolis Company No. 3 consolidated with the Minneapolis & St. Louis Railroad & Telegraph Company, a corporation of the State of Iowa, forming the Minneapolis & St. Louis Railroad Company of Minnesota and Iowa, a new corporation, or Minneapolis Company No. 4, which existed from 1895 to May 10, 1916.

I would also find that on or about December 22, 1898, the Minneapolis & St. Louis Railroad Company (Minneapolis Company No. 4), the new corporation, under lawful authority duly executed and delivered its mortgage or deed of trust to the Central Trust Company of New York as trustee (Central Union Trust Company of New York, present trustee), wherein and whereby the Min-
14 neapolis Company granted, sold, conveyed, transferred, pledged, and set over to Central Trust Company of New York as trustee the line of railway and properties therein described to secure an issue of $25,000,000.00 first and refunding mortgage bonds, $13,244,000.00 of which were issued and are now outstanding and unpaid and constitute the valid, binding, and legal obligations of the present Minneapolis & St. Louis Railroad Company. That said mortgage was at that time duly recorded as required by law in each county in which the lines of railway and other properties of the mortgagor covered by said mortgage were situated or located and that by virtue of such recordation under statutory law said mortgage became a lien upon all the properties so mortgaged and that said lien continued to and still exists with full force and effect.

I would also find that on or about January 1, 1912, the Minneapolis & St. Louis Railroad Company (Minneapolis Company No. 4), the new corporation, under lawful authority duly executed and delivered its mortgage or deed of trust dated January 1, 1912, to the Guaranty Trust Company of New York as trustee, wherein and whereby the Minneapolis Company granted, sold, conveyed, transferred, pledged,

and set over to the Guaranty Trust Company of New York as trustee the line of railway and properties therein described to secure an issue of $75,000,000 refunding and extension mortgage bonds, $8,895,000 of which were issued and are now outstanding and unpaid and constitute the valid, binding, and legal obligations of the present Minneapolis & St. Louis Railroad Company. That said mortgage was at that time duly recorded as required by law in each county in which the lines of railway and other properties of the mortgagor covered by said mortgage were situated or located and that by virtue of such recordation under statutory law said mortgage became a lien upon all the properties so mortgaged and that said lien continued to and still exists with full force and effect.

That on January 1, 1912, Minneapolis Company No. 4 purchased the Minnesota, Dakota & Pacific Railroad Company, the owner of about 229 miles of railway located in South Dakota, and on January 1, 1912, it also purchased the Iowa Central Railway Company, an Iowa corporation operating approximately 500 miles of railroad in the States of Iowa and Illinois.

That said Iowa Central Railway Company on or about August 1, 1888, under lawful authority duly executed and delivered its mortgage or deed of trust, dated August 1, 1888, to the Mercantile Trust Company of New York as trustee (Bankers Trust Company of New York, present trustee), wherein and whereby the Iowa Central Railway Company granted, bargained, sold, conveyed, transferred, pledged, and set over to the Mercantile Trust Company as trustee, the line of railway and properties therein described to secure an issue of $7,650,000.00 of its first mortgage gold bonds, all of which are now outstanding and unpaid and constitute the valid, binding, and legal obligations of the present Minneapolis & St. Louis Railroad Company. That said mortgage was at that time duly recorded as required by law in each county in which the lines of railway and other properties of the mortgagor covered by said mortgage were situated or located and that by virtue of such recordation under statutory law said mortgage became a lien upon all the properties so mortgaged and that said lien continued to and still exists with full force and effect.

That said Iowa Central Railway Company had also on or about August 16, 1901, under lawful authority duly executed and delivered its mortgage or deed of trust dated March 1, 1901 (effective August 16, 1901), to the Morton Trust Company of New York as trustee (Central Union Trust Company of New York, present trustee), wherein and whereby the Iowa Central Railway Company granted, bargained, sold, conveyed, assigned, transferred, pledged, and set over to the Morton Trust Company of New York as trustee the line of railway and properties therein described to secure an issue of its first and refunding gold bonds in the principal sum of $25,000,000.00, $7,156,000.00 only of which were issued and are now outstanding and unpaid and constitute the valid, binding, and legal obligations of the present Minneapolis & St. Louis Railroad Com-

pany. That said mortgage was at that time duly recorded as required by law in each county in which the lines of railway and other properties of the mortgagor covered by said mortgage were situated or located and that by virtue of such recordation under statutory law said mortgage became a lien upon all the properties so mortgaged and that said lien continued to and still exists with full force and effect.

On August 9, 1915, Minneapolis Company No. 4 purchased the properties of the Des Moines & Fort Dodge Railroad Company, an Iowa corporation operating approximately 140 miles of road in the State of Iowa. The Des Moines & Fort Dodge Railroad Com-
16 pany had previously and on or about the 1st day of January, 1905, under lawful authority duly executed and delivered its mortgage or deed of trust dated January 1, 1905, to Central Trust Company of New York as trustee (Central Union Trust Company, present trustee), wherein and whereby the Des Moines & Fort Dodge Railroad Company granted, bargained, sold, conveyed, assigned, transferred, pledged, and set over to Central Trust Company of New York, as trustee, the line of railway and properties therein described to secure an issue of $3,072,000.00 of its first mortgage bonds, all of which were issued and are now outstanding and unpaid, and constitute the valid, binding, and legal obligations of the present Minneapolis & St. Louis Railroad Company. That said mortgage was at that time duly recorded as required by law in each county in which the lines of railway and other properties of the mortgagor covered by said mortgage were situated or located and that by virtue of such recordation under statutory law said mortgage became a lien upon all the properties so mortgaged, and that said lien continued to and still exists with full force and effect.

On May 10, 1916, Minneapolis Company No. 4 consolidated with the Iowa Central & Western Railroad Company, an Iowa corporation, operating approximately 38 miles in the State of Iowa, forming the Minneapolis & St. Louis Railroad Company or Minneapolis Company No. 5, a new corporation, which constitutes the present system of railroad now operated by the receiver and which constituted the line of railroad operated by the United States during the period of Federal control, and in connection with the operation of which the items of asserted indebtedness of the United States originated and accrued.

That defaults in payment of interest or principal or in the performance of some mortgage obligations with respect to each of the mortgages above described, except the so-called Merriam Junction-Albert Lea mortgage, have taken place, and that pursuant to the terms and provisions of said mortgages the present respective trustees duly filed in this court their bills of complaint to foreclose said mortgages and each of them as fully appears in the printed record in this receivership proceedings, and to which reference is made for greater particularity. That the taking of evidence under said bills to foreclose, and each of them, has been completed, and that

the undersigned as master has made and filed his final report with respect thereto, and in which he found and now so finds that defaults have been made as alleged in said bills of foreclosure, that the said mortgages and each of them were duly executed under
17 lawful authority to secure the payment of the bonds as hereinbefore recited at length. That in said report the undersigned as master recommended that a decree of foreclosure and sale be entered and that the parties to the various bills of complaint be granted a judgment in accordance with the various prayers for relief contained therein. That said bonds were and now are the valid outstanding and lawful indebtedness of the present Minneapolis & St. Louis Railroad Company. That company under its agreement of purchase with the Iowa Central Railway Company and the Des Moines & Fort Dodge Railroad Company having assumed the payment of the bonds issued under the Iowa Central first mortgage, the Iowa Central first and refunding mortgage and the Des Moines & Fort Dodge first mortgage. That the said mortgages and each of them were at the time of their execution and delivery duly recorded as provided by law, and that thereupon said mortgages, and each of them, became a lien upon the railway and properties described therein, and that said lien has never been disturbed or destroyed, and continued to and still exists with full force and effect. That these mortgages, and each of them, had not yet matured at the time of the operation and control of Minneapolis & St. Louis Railroad Company (Minneapolis Company No. 5) by the United States and that the lien of said mortgages, and each of them, during all the time of said operation was in full force and effect.

That pursuant to an order of court dated August 20, 1923, and others subsequent thereto, made in cause 299 consolidated with 290, a large number of creditors including the United States, to wit: 4,500, having claims and demands against the Minneapolis & St. Louis Railroad Company, duly filed with the undersigned as special master their verified proofs of claims. That nearly all of these claims and accounts have been heard by the special master, and a large amount has been determined by him as entitled to a preference in payment. That at the hearing upon a group of claims, including the Albia Coal Company, the question was raised by counsel for claimants with respect to the diversion of funds by the Minneapolis & St. Louis from the payment of current operating expenses, within six months prior to the appointment of the receiver herein, to the liquidation of interest coupons falling due upon the mortgages involved in the six foreclosure cases now under consideration and other purposes which under the rule of law laid down in Fos-
18 dick vs. Schall, 99 U. S. 235, would constitute a fund for which in equity the trustees on a sale of the properties under foreclosure decree must account to and reimburse the parties entitled to payment. Evidence was presented upon the question of diversions, and the master subsequently filed a report in which he held that a large sum of money had been so diverted. Exceptions were filed to

this report, which were substantially overruled by the court, and later an appeal was taken from the order by the trustees of the six mortgages under foreclosure, the claimants and the Bennett and Bache committees. This appeal at the present writing has not been finally determined by the Appellate Court. If the decision of the District Court is affirmed, a substantial sum will be available under the doctrine of diversions for the payment of preferred claims of the character designated in Fosdick vs. Schall, supra.

I would also find that during the proceedings had at the time these claims were heard counsel for the Government stated in open court that the case of Mellon, Director General, vs. Michigan Trust Company, 271 U. S. 236, in which governmental priority was denied, would apply to claim No. 3268, and also to items Nos. 3 and 5 of claim No. 2700 for $625,000.00 each.

I would also find that the condition of the Minneapolis & St. Louis Railroad Company in July, 1923, was such as to establish a case of insolvency under the ruling made by the Supreme Court of the United States in the case of United States vs. Butterworth-Judson Corporation, 269 U. S. 504.

As further conclusions of law in addition to those already heretofore made and especially those in respect to the lien of the various mortgages executed by the constituent companies of the new corporation, at present the Minneapolis & St. Louis Railroad Company, I would find that the fund ultimately established, if any, through the doctrine of principle of diversions is a special one created and established exclusively and solely for the benefit of the preferred supply operating creditors whose claims were properly proven and allowed as such and that the United States of America nor James C. Davis, Director General of Railroads (Andrew Mellon, successor), are not entitled to participate in the distribution of this fund or of any part thereof.

That the various instruments of pledging under which the Minneapolis & St. Louis refunding and extension class "A" mortgage bonds and also other collateral were given to secure the payment of certain specified items or accounts in claims No. 2700 and
19 4186 are valid and subsisting and outstanding contracts and that the United States of America and James C. Davis, Director General of Railroads (Andrew Mellon, successor), are entitled to realize upon the securities so pledged in accordance with the terms and the provisions of said pledging instruments and that the claimant in each instance is entitled to enforce all the provisions thereof in accordance with their terms.

Claims or items allowed

Claim No. 1827

I would also find that there is due and owing to the United States of America on account of claim No. 1827, $100.00, and that it is

entitled to recover from the Minneapolis & St. Louis Railroad Company and its receiver the said sum of $100.00 as a special preference claim, to be paid out of the current net operating income of the receiver as a special charge thereon or from any other funds which may be available for such purpose.

Claims Nos. 2700, 4186, and 3268

I would also find that the United States of America is entitled to recover from the Minneapolis & St. Louis Railroad Company as a general account or liability from the securities deposited as collateral and pro rata with other claims of like class from such funds in the hands of the court in this cause as may now or hereafter be available for that purpose, without any preference or priority in payment except as to collateral security either against the corpus of the mortgaged properties or any other claim, class or classes of claims, account or accounts against the Minneapolis & St. Louis as duly filed in this cause or any of the parties hereto, the following sums found due and allowed by me. The total amount which it is entitled to recover from the proceeds of collateral and other sources shall not exceed, however, the total of the claims as allowed.

Claim No. 2700

On account of item No. 1 the principal sum of $1,382,000 without interest.

On account of item No. 3 of said claim the principal sum of $625,000.00 without interest.

On account of item No. 4 of said claim the principal sum of $625,000.00 without interest.

20 Claim No. 4186

That the United States of America is entitled to recover only as above stated, either from the Minneapolis & St. Louis Railroad Company or a purchaser at the foreclosure sale, on account of claim No. 4186 such amount, if any, as may ultimately be found due to the United States of America in the process of the litigation referred to in my findings of fact.

Claim No. 3268

That James C. Davis, Director General of Railroads (Andrew Mellon, successor), is entitled to recover from the Minneapolis & St. Louis Railroad Company on account of the indebtedness asserted in claim No. 3268 the sum of $85.35.

Claims or items disallowed

Claim No. 2700

That the United States of America is not now entitled to recover from the Minneapolis & St. Louis Railroad Company or its receiver

the asserted indebtedness alleged to be due in item No. 2 of claim No. 2700 for $386,190 (since reduced), and item No. 5 of my claim No. 2700 for $403,200 (since reduced) or any part thereof.

Claim No. 4153

That the United States collector or internal revenue for the district of Minnesota is not entitled to recover any sum or sums whatever on account of the indebtedness set out in claim No. 4153.

A memorandum stating my reasons for the above conclusions of law follows and in this respect may be considered a part of my report.

All of which is respectfully submitted.

HOWARD S. ABBOTT,
Special Master in Chancery.

Minneapolis, Minnesota, August 13, 1928.

In United States District Court

Memorandum opinion

Filed Aug. 13, 1928

The question of whether the Minneapolis & St. Louis Railroad Company is insolvent within the meaning of section 3466, U. S. Rev. Stat., section 6372 U. S. Comp. Stat., so as to establish the
21 right, other conditions permitting, of the United States to the priority in payment asserted in that section would seem to be settled by the case of the United States vs. Butterworth-Judson Corporation, 269 U. S. 504, and in which the opinion was written by Mr. Justice Butler. The facts are stated in the opinion and from that recital it would seem that the condition of the Minneapolis & St. Louis Railroad Company in July, 1923, was similar to that of the defendant corporation in the case above, where the court held that the respondent's answer admitting the allegations of the complaint and its consent to a decree appointing receivers would amount to the handing over of all of its properties and business to the receivers to be administered under the direction of the court as a trust fund to pay the debts of respondent or,

"in substance, the things done by respondent amounted to a voluntary assignment of all its property within the meaning of section 3466,"

and the court in that case held that the United States was entitled to priority. The syllabus of this case prepared by the court follows:

"Corporation in fact insolvent, which consented to appointment of receiver in suit wherein solvency, but mere inability to meet maturing obligations was alleged, held to have made a voluntary assignment for benefit of creditors, within Rev. Stat., sec. 3466, Comp. Stat., sec. 6372, giving priority to debts due the United States in cases of insolvency."

The five claims filed on behalf of the United States of America and heard by the master on May 21, 1928, except two, cover indebtedness incurred, directly or indirectly, during the period of Federal control or soon thereafter. In order to have the facts and question for determination clearly in mind, a brief statement of the amounts involved and the nature and character of the claims is pertinent. These claims were filed on behalf of the United States of America with the master on the dates stated and assigned the numbers given below.

Claim No. 1827

Claim No. 1827, filed December 7, 1923, for $100.00, based on fine imposed on plea of guilty by the United States District Court for the Northern District of Illinois for a violation of the quarantine act. Admitted.

22 Claim No. 2700

Claim No. 2700, filed December 26, 1923, comprising five items of asserted indebtedness.

(1) Promissory note for $1,382,000.00 made by the Minneapolis & St. Louis Railroad Company, Secretary of the Treasury, payee, dated April 1, 1921, due April 1, 1931, representing a loan to the carrier pursuant to the provisions of section 210 of the transportation act of 1920, as amended. Liability admitted.

(2) Promissory note of the National Railway Service Corporation, the United States of America or order of the Secretary of the Treasury, payee, for $386,190.00 (since reduced), dated July 1, 1921, due June 1, 1936, issued in connection with contract No. 2 entered into by the carrier under an equipment trust agreement, Series "A," lease basis, dated June 1, 1921, executed by the National Railway Service Corporation to the Bankers Trust Company of New York as trustee. Liability denied.

(3) Promissory note for $625,000.00 of the Minneapolis & St. Louis Railroad Company, Director General of Railroads payee, dated May 27, 1922, due March 1, 1930, representing indebtedness of the carrier to the United States at the termination of Federal control and funded pursuant to the provisions of section 207 of the transportation act, 1920. Liability admitted.

(4) Promissory note of the Minneapolis & St. Louis Railroad Company for $625,000.00, Director General of Railroads payee, dated April 1, 1923, due on demand and representing indebtedness of the carrier to the United States at the termination of Federal control and funded pursuant to the provisions of section 207 of the transportation act, 1920. Liability admitted.

(5) $403,200.00 (since reduced) evidenced by twelve promissory notes of the Minneapolis & St. Louis Railroad Company for $33,600.00 each, Director General of Railroads, payee, each dated January 15, 1920, and maturing successively upon the 15th day of Janu-

ary, 1924 to 1935, inclusive, representing equipment purchased and allotted to the carrier during the period of Federal control pursuant to the provisions of the act of Congress approved November 19, 1919, and issued under equipment trust agreement dated January 15, 1920. Liability denied.

23

Claim No. 3268

Claim No. 3268, filed January 2, 1924, for $85.35 on account of the Minneapolis & St. Louis Railroad Company's proportion of two loss and damage claims in connection with the interchange of traffic between the Northern Pacific Railway Company and the Minneapolis & St. Louis Railroad Company during the period of Federal control. Liability admitted.

Claim No. 4153

Claim No. 4153. Withdrawn by claimant.

Claim No. 4186

Claim No. 4186, filed under order of court May 26, 1924, for $292,022.23, representing alleged overpayment by the Government in connection with the adjustment of accounts with respect to guaranty under section 209 of the transportation act of 1920. Liability denied as to amount claimed.

Counsel for the Government upon the hearing conceded that claim 3268 should be allowed as a general liability only following Mellon, Director General vs. Michigan Trust Co., 271 U. S. 236, 46 Sup. Ct. Rep. 511.

Items 2 and 5 of the Government's claim, my No. 2700, for $386,190.00 (since reduced) and $403,200.00 (since reduced), respectively, are based upon equipment trust obligation incurred in the purchase or allocation of equipment during the period of Federal control or under the transportation act of 1920, as amended. These obligations are in the form of promissory notes. One for $386,190.00 (since reduced) given by the National Railway Service Corporation to the United States of America or order of the Secretary of the Treasury as payee, and which is not due until June 1, 1936, the other sum of $403,200.00 (since reduced), the aggregate of twelve promissory notes of $33,600.00 each, maturing successively on the 15th day of January, 1924 to 1935, inclusive. The interest upon these obligations and the principal of notes falling due has been promptly paid on maturity by specific and direct orders of the court in this receivership proceeding. The equipment trust contracts made before the receivership covering the equipment in question and for which the obligations were incurred were adopted by the receiver with the approval of the court; the relation therefor between the holder of the notes or obligations and the railroad company is a contract one, and the matuarity of the obligations was not accelerated

upon the passing of the road into the hands of the receiver.
24 No default having taken place either in respect to the conditions of the equipment trust agreements or the obligations themselves, these two items of claim No. 2700 are necessarily disallowed.

There remains, therefore, for further consideration and discussion three items of claim No. 2700, No. 1 for $1,382,000.00, No. 3 for $625,000.00, and No. 4 for $625,000.00 and claim No. 4186 for $292,022.23. The last three items—namely, Nos. 3 and 4 and claim No. 4186—are all based upon operations occurring during the period of Federal control and originated in connection with financial transactions arising out of the use of the system of railroad of the Minneapolis & St. Louis Railroad Company by the United States during Federal control. The conclusions reached as to the priority asserted under section 3466, Revised Statute, apply generally and especially to these three items as well as that for $1,382,000. Some reference to the facts pertaining to the claims other than item No. 1 for $1,382,000.00 will be stated more at length and separately. Item No. 1 of claim, my No. 2700, consists of a promissory note for $1,382,000.00, originally dated April 1, 1921, that date being changed subsequently to April 2, 1921, the first falling on Sunday. The period of Federal control terminated at 12.01 a. m. March 1, 1920, but by the transportation act of 1920 provision was made for the settlement and adjustment of all transactions and mutual accounts arising during the perior of Federal control between the Government and the carriers. In section 210 of that act as amended June 5, 1920, provision was made for the making of advances by the Government to carriers for the purpose of meeting maturing indebtedness. The circumstances under which this note was given are these: (June 1, 1881, the Minneapolis & St. Louis Railroad Company duly executed a mortgage, known as the Pacific extension mortgage, to the Empire Trust Company of New York as trustee, to secure its 6% gold bonds in the amount of $1,382,000.00. The bonds issued under this mortgage were secured by a first lien on 94.34 miles of road extending from Hopkins to Morton, Minnesota, and also a junior lien on 9 miles of road extending from Minneapolis to Hopkins, Minnesota. These bonds matured April 1, 1921, and under the provisions of section 210 the United States advanced to the Minneapolis & St. Louis Railroad Company $1,382,000.00, payable in ten years, and on that date it executed and delivered the promissory note for a like amount and referred to above. At that time also $2,377,000.00 par value of the Minneapolis & St. Louis refunding and extension bonds were deposited with the proper authority as collateral for the loan.
25 The interest on this note was paid by the railroad company up to and including the installment of interest due and payable on April 1, 1923. The nature and circumstances under which the asserted indebtedness originated for items No. 3 and 4 of claim No. 2700 for $625,000.00 each and claim No. 4186 for $292,022.23 sufficiently appear in the findings of fact.

The Minneapolis & St. Louis Railroad Company as operated by the Government and now in receivership is the result of consolidations and purchases by other railroad corporations which are now nonexistent, the last consolidation having taken place May 10, 1916. The claim of the United States is only against the present Minneapolis & St. Louis Railroad Company, and its asserted priority can be therefore only against the property of this company. The present company has never owned anything except an equity of redemption in its properties, subject to various mortgages as hereinafter stated, since all these mortgages were made by prior corporations. When received by the present company, the property so received was already subject to these liens. Stated differently, all of the constituent lines of the present Minneapolis & St. Louis operated by the Government during the period of Federal control had long prior to that period duly executed mortgages upon either portions of the present system or the entire road, which had been duly recorded pursuant to the laws of different States, and the debt evidenced by the bonds issued under the mortgages had become a lien upon the property specified therein. There is no question with respect to either the facts or the law in this respect.

The mortgages thus executed, with the dates of execution, are the Minneapolis & St. Louis Merriam Junction-Albert Lea, dated February 1, 1877; first consolidated, dated November 1, 1884; first and refunding, dated March 1, 1899, and refunding and extension, dated January 1, 1912; Iowa Central first mortgage, dated June 1, 1888, and first and refunding mortgage, dated March 1, 1901; and the Des Moines & Fort Dodge first mortgage, dated January 1, 1905. No one of these mortgages at the date of the appointment of the receiver, on July 26, 1923, was due and payable. No one of them had been satisfied or discharged of record and all of them are still liens with varying degrees of priority upon the properties of the present Minneapolis & St. Louis Railroad Company or a part thereof.

The asserted indebtedness of the United States upon which
26 its claims, except Nos. 1827 and 3268, are based, are evidenced by promissory notes or certificates of indebtedness, the earliest in point of time being the equipment trust notes, January 15, 1920. The indebtedness for which these obligations were given in liquidations arose out of an advance by the United States to the railroad company, the purchase of equipment and the adjustment of financial transactions as between the Government and the railroad company all occurring during the so-called period of Federal control or soon thereafter. One claim, No. 4153, based upon an alleged underpayment on account of internal revenue, was withdrawn.

It is clear that the mortgage debts above noted constituted and for many years prior to the transactions between the United States and the railroad company had constituted and were liens upon the property of the Minneapolis & St. Louis, established and created by law under the recording provisions of the different States. These mort-

gages, dated from February 1, 1877, to January 1, 1912, were and have been since the date of their respective execution lawfully created, valid, binding, and existing obligations, and the bonds issued pursuant to the provisions thereof are in the hands of numerous bona fide holders for value and who are legally entitled to the lien and security of the mortgages so executed. There is no question but that the debts due the mortgage creditors are liens upon the properties of the railroad company.

July 26, 1923, W. H. Bremner was duly appointed receiver for the Minneapolis & St. Louis Railroad Company. On August 20, 1923, an order was made which provided for the filing with the undersigned as special master the claims of all creditors of the Minneapolis & St. Louis other than those secured by mortgage. Later orders were made which referred to the undersigned as special master for hearing and determination all questions arising in connection with the proceedings brought to foreclose the mortgages above noted with the exception of the Merriam Junction-Albert Lea mortgage.

Pursuant to the order of August 20, 1923, the United States of America duly filed with the master five claims which were assigned by him the following numbers: 1827, 2700, 3268, 4153, and 4186, the date of filing being, respectively, December 7, 1923; December 26, 1923; January 2, 1924; April 10, 1924 (filed under order of court); and May 26, 1924 (filed under order of court).

The dates when the asserted indebtedness or liability, the basis of these five claims, originated being, claim No. 1827,
27 April 2, 1921; claim No. 2700, item 1, April 2, 1921; item 2, July 1, 1921; item 3, May 27, 1922; item 4, April 1, 1923; and item 5, January 15, 1920; claim No. 3268, February 18 and March 18, 1920; and claim No. 4186, date certificate, April 14, 1924. Claim No. 4153 withdrawn.

By comparing these dates with those of the execution of the various mortgages referred to it is beyond dispute that the lien of even the latest mortgage was created and in force long prior to the time when the indebtedness between the United States and the railroad company accrued.

The facts involved are substantially conceded, the principal questions of law before the master are few in number and may be stated briefly as follows:

(a) Whether the United States is entitled to a priority or preference in payment, and,

(b) If entitled to a priority, what is the relative priority as against,

(1) The debt secured by the specific and vested lien of prior recorded mortgages;

(2) The fund which may be established through the doctrine of diversions, and,

(3) The other unsecured creditors of the railroad company.

The King's prerogative, scope, and extent

The King's prerogative as existing in the earliest times and as stated in Coke's case was almost unlimited with respect to the collection of debts due the Crown. It must be remembered, however, that the King's priority with reference to debts due the Crown was substantially modified by 33 Hen. 8 C. 39, and this statute was in force in England at the time of our independence. There are many English cases discussing the question of relative priorities as between the King and a subject, but one only may be cited as illustrating the principles followed in these decisions, namely, that of Giles v. Grover, 9 Bing. 128. In this case opinions were delivered by a number of judges sitting, and among them Patteson and Alderson. Justice Patteson, after referring to the rule which gave the King priority in the case of concurrent debts, said (p. 139):

"In this respect it differs from all cases of special property and charges on goods created by the debtor while he has the
28 absolute dominion over the goods. It is conceded that the Crown can not avoid an equitable mortgage, Casberd v. Attorney General, 6 Price 411; or the lien of a factor, The King v. Lee, 6 Price 369; or of a wharfinger, The King v. Humphrey, 1 McCleland & Younge 173; or a bona fide assignment in trust for creditors, The King v. Watson, West on Extents 115, or any other similar assignment or charge because they are created when the debtor has legal power and authority to create them and attach upon the goods before the process of the Crown, and the Crown can only take the goods subject to such liabilities as the debtor has legally created."

Justice Alderson in the same decision said on the same point:

"If, however, the right of the subject be complete and perfect before that of the King commences it is manifest that the rule does not apply, for there is no point of time at which the two rights are in conflict; nor can there be a question which of the two ought to prevail in a case where one, that of the subject, has prevailed already."

In United States v. State Bank of North Carolina, 6 Peters 29, Mr. Justice Story in writing the opinion said:

"The right of priority of payment of debts due to the Government is a prerogative of the Crown, well known to the common law. It is founded, not so much upon any personal advantage to the sovereign, as upon motives of public policy, in order to secure an adequate revenue to sustain the public burdens and discharge the public debts. The claim of the United States, however, does not stand upon any sovereign prerogative, but is exclusively founded upon the actual provisions of their own statutes. The same policy which governed in the case of the royal prerogatives may be clearly traced in these statutes."

The soundness of the principle that even the King's right of priority could not displace the prior vested right or lien of a subject was stated by our own Supreme Court in Marshal v. People of the State of New York, 254 U. S. 380, where the question of the priority of the State of New York out of the general assets of a debtor over other creditors was based upon the common law and the court there said in discussing the prior right of the State of New York, as a sovereign and prerogative right:

"At common law the Crown of Great Britain, by virtue of a prerogative right, had priority over all subjects for the
29 payment out of a debtor's property of all debts due it. The priority was effective alike whether the property remained in the hands of the debtor, or had been placed in possession of a third person or was in custodia legis. The priority could be defeated or postponed only through the passing of title to the debtor's property, absolutely or by way of lien, before the sovereign sought to enforce its right."

No common law in Federal courts

It is conceded that in the Federal courts there is no common law, and it is only necessary to cite a few cases supporting this principle.

United States v. State Bank of North Carolina, 6 Pet. 29.

Stripe v. United States, 269 U. S. 503.

Mellon v. Michigan Trust Company, 271 U. S. 236, affirming Davis v. Michigan Trust Company, 2 Fed. (2) 194.

Equitable Trust Company v. Connecticut Brass & Mfg. Corp., 290 Fed. 712.

Liberty Mutual Insurance Company v. Johnson Shipyards Corp., 6 Fed. (2d) 752.

United States v. Middle States Oil Corp., 18 Fed. (2d) 231.

Since the United States has no common law, whatever right of priority in the payment of debts the United States has over other creditors is there because of some statute which confers it. The right of priority does not exist independently of statute. To remedy the absence of the right of the sovereign to priority, the first Congress passed an act giving to the United States a right to priority of payment over other creditors in the case of bonds given by public officers for the collection of duties. It was dated July 1, 1789, and was entitled, an "Act to regulate the collection of duties imposed by law, etc.," and then declared that in all cases of insolvency or where a debtor's estate in the hands of executors or administrators should be insufficient to pay all the debts due from the deceased the debts of the United States should be first satisfied. The act of March 3, 1797, with some slight verbal changes which do not alter its meaning is embodied in section 3466 U. S. Rev. Stat. and section 6372 U. S. Comp. Stat. This section in so far as affects the present claims of the United States can be quoted as follows:

"Whenever any person indebted to the United States is in-
30 solvent or whenever the estate of any deceased debtor, in the hands of the executors or administrators, is insufficient to pay all the debts due from the deceased the debts due to the United States shall be first satisfied; and the priority hereby established shall extend as well as to cases in which a debtor, not having sufficient property to pay all his debts, makes a voluntary assignment thereof, or in which the estate and effects of an absconding, concealed, or absent debtor are attached by process of law, as to cases in which an act of bankruptcy is committed."

This section makes the United States a privileged creditor. It is, so far as the law goes, but no further. It is not a prerogative superseding the title or the vested liens of others on the properties of a debtor. The claims in question, except one and one withdrawn, are not for taxes due the United States or for a debt which partakes to any extent or in any degree of that character. One claim is for a simple advancement or loan of money made pursuant to law for the purpose of enabling the Minneapolis & St. Louis to meet a maturing obligation. The others are for obligations given by the United States in adjustment of financial transactions between the United States and the Minneapolis & St. Louis originating while the Government was operating its properties as an owner under emergency legislation passed in connection with the late war.

Priority sections do not create a lien

It is also conceded that this section does not give the United States a lien upon its debtors' property, but only a right to a priority of payment out of the same in certain cases. In support of this rule it is only necessary to cite, United States vs. Fisher, 2 Cranch, 358, opinion by Chief Justice Marshall, and to note that this decision on this point has been invariably and uniformly followed in all decisions of the Federal courts. The section gave only to the United States a priority of payment out of the property or assets of the insolvent debtor after it has passed by voluntary assignment or by operation of law to a third person for the benefit of creditors. It is equally clear that any creditor including the United States can participate in the distribution of properties or funds belonging to the Minneapolis & St. Louis Railroad Company in the hands of its receiver and as to which he has the right or power of disposal and that if on this property in the hands of the receiver a prior vested lien has attached that property must be disposed of or taken by creditors subject to the liens, whatever they may be. Again, the priority of the United States, it is conceded, does not con-
31 stitute a lien at the time the debt to the United States originated, but leaves the power of alienation free either in the creation of a lien or an alienation either total or partial. If the lien be an alienation to the amount of a debt incurred by the debtor prior to insolvency, then clearly, for the amount of that lien the

priority of the United States can not attach and the same effect must be produced whether the lien be created by the act of the party or by the operation of law.

Review of priority decisions

Up to this point the argument against priorities has been based upon the nature and extent of the sovereign right to priorities as construed by English decisions, the nonexistence of common law in the Federal courts, the passage of the act of 1797 to supplement the absence of a sovereign right of priorities and the holdings that the statute in question never did nor does it now create or establish a lien. Let us consider now the cases decided by the Federal courts, particularly those of the Supreme Court of the United States, construing and explaining the statute, section 3466, in question. In spite of the statement of counsel for the Government to the contrary it can be fairly said that no decision of the Federal courts has ever held that section 3466, U. S. Rev. Stat., gives the United States a priority right for payment which would displace a valid, specific, and existing lien upon the property of the debtor, created prior to the debt due the United States, either by the debtor when he had the power of control or by act of law. The thought itself, that this could be done, is repugnant to all rules or principles of equity. The fundamental principle is well stated in the Giles vs. Grover case, supra, where Judge Alderson said:

"Nor can there be a question which of the two ought to prevail in a case where one, that of the subject, has prevailed already."

The statute provides that the debts of the United States must be first satisfied, but out of what? And the answer is, out of property of the debtor, out of the interest of the debtor only in his property, out of that only which he owned at the time of the insolvency, and he only owned that which was free from the impress of the law which had created a right or interest in others secured by lien. Any interest which the debtor had conveyed while he had legal control, by way of conveyance, mortgage, or other lawful act, clearly can not be considered as the property of the debtor. That interest,
32 which was covered by a lien created by his own act or through operation of law he did not own, it was not his; it was a tangible something that had passed beyond his control and reach, beyond his power of distribution, and of which he had been lawfully divested.

Considering the earlier cases in the Supreme Court of the United States and first that of The United States vs. Hooe, et al., 3 Cranch 73.

That part of the opinion in United States vs. Hooe et al., 3 Cranch 73, which holds that the priority of the United States under section 3466 does not supersede a valid mortgage given by the debtor before his insolvency has been asserted by the counsel for the Govern-

ment as dictum and also as based upon the theory that a mortgage operated as divesting the title of the mortgagor. Neither point is well taken, in my judgment. More than a brief examination of this case is apparently necessary. The opinion was written by Chief Justice Marshall and decided and rendered in 1805. The material facts in the case as found by the court are concisely stated as follows:

One Fitzgerald upon being appointed collector of internal revenue executed a bond to the United States with Hooe as surety in the penalty of $10,000.00 for the faithful performance of the duties of his office. In 1798 he was found to be greatly in arrears, and upon a final adjustment of his accounts the balance against him was over $57,000.00. In 1799 Hooe, having knowledge that Fitzgerald was largely indebted to the United States, but believing that he had sufficient property to discharge the debt, and Fitzgerald being desirous of borrowing money from the Bank of Alexandria to meet the drafts of the Treasury of the United States and for other purposes, made a deed of trust to W. and J. C. Herbert, reciting that Hooe had become surety of Fitzgerald on the bond to the United States and that he purposed obtaining money from the Bank of Alexandria and to draw notes to be endorsed by Hooe whereby the latter might be liable and compelled to pay the same, and that Fitzgerald being desirous of securing and indemnifying Hooe from all damages, costs, and charges which he might at any time thereafter be subject and liable to, by reason of any misconduct of Fitzgerald in the discharge of his duties as collector, or for or on account of ready notes drawn by him, endorsed by Hooe and negotiated at the Bank of Alexandria. The indenture then witnessed that for those purposes and in consideration of the trusts and confidence therein expressed and of one dollar, Fitzgerald bargained and sold to
33 the trustees certain real estate described in said indenture, in trust, to and for the use and purposes mentioned in said indenture and for no other use and purpose whatsoever. Fitzgerald died in December, 1799, and directed by will that his real estate be sold for the payment of his debts. In 1801 the Attorney General of the United States filed a bill in equity against Hooe, the two Herberts, and the executors, widow, and heirs of Col. John Fitzgerald, the collector named above.

At the November term in 1802 the court entered its decree, in which it was recited:

"The objects of the bill filed in this cause were to set aside a deed executed on the 16th of January, 1799, by John Fitzgerald to Wm. Herbert and John C. Herbert, conveying certain property therein mentioned, in trust, for the purpose of indemnifying Robert Townsend Hooe, as indorser of certain notes negotiable in the Bank of Alexandria, and as surety of John Fitzgerald, in his office of collector of the port of Alexandria; to oblige the said trustees to account with the United States for the said real property, and to com-

pel the executors to account for the personal estate of the said John Fitzgerald, and to pay the same to the United States towards the discharge of the balance due from him; and further to restrain and enjoin the said trustee from making sale of the said real property."

The decree then further provided that certain notes negotiated after the deed of trust should be paid out of the proceeds of the sale and balance paid according to the terms of the deed of trust to the United States in part liquidation of the debt due from Fitzgerald to the United States. A writ of error was issued to reverse this decree. It was contended by the United States that Fitzgerald had the right to sell and alienate the property, but it did not follow that he could, by a mortgage or an assignment, prefer a particular creditor to the United States, and that under the statute if a man was unable to pay all his debts and attempted to give a particular preference, his hand should be stopped until the debt due the United States should be satisfied, and if it turned out that he was actually insolvent the United States, and not the individual creditor, should have the preference. That the United States had a right to the whole of Fitzgerald's estate in the first place, and that if it was insufficient to pay the debt, it might resort to Hooe for the whole penalty of the bond,

if necessary. It was contended on the contrary that the debt was
34 bona fide and valid, that it was not invalidated by any statute of the United States. That there was no evidence at the time it was given of the insolvency of Fitzgerald; that although Fitzgerald remained in possession, yet, it being real estate, possession was no mark of fraud and could not deceive or defraud others, because the deed must of necessity be upon record. That Fitzgerald, assuming that he was actually unable to pay all his debts at the time of the execution of the deed of trust, yet, as his property was not divested by act of law, nor by such a voluntary assignment as is contemplated by the act of Congress, the priority of the United States had not attached so as by any possibility to avoid the deed of trust.

Chief Justice Marshall in delivering the opinion of the court said:

"The first point made in this case, by the attorney for the United States, is that the deed of the 16th of January, 1799, is fraudulent as to creditors generally.

The second point for which the plaintiffs contend is that this is a case in which the priority of payment claimed by the United States in cases of insolvency intervenes and avoids the deed."

Upon the first point the Chief Justice said:

"But the difference is a marked one between a conveyance which purports to be absolute, and a conveyance which, from its terms, is to leave the possesison in the vendor. If, in the latter case, the retaining of possession was evidence of fraud, no mortgage could be valid. The possession universally remains with the grantor, until the creditor becomes entitled to his money, and either chooses or is compelled to exert his right. That the grantor is to receive the rents and profits till the grantee shall become entitled to demand the money which the deed is intended to secure is a usual covenant."

Upon the second point he said:

"In construing the statutes on this subject, it has been stated by the court, on great deliberation, that the priority to which the United States are entitled does not partake of the character of a lien on the property of public debtors. This distinction is always to be recollected."

And further:

"If a debtor of the United States, who makes a bona fide
35 conveyance of part of his property for the security of a creditor, is within the act which gives a preference to the Government, then would that preference be in the nature of a lien from the instant he became indebted, the inconvenience of which, where the debtor continued to transact business with the world, would certainly be very great."

The court then construes the term "insolvency" as applied to the facts in the case before it. The second paragraph of the syllabus prepared by the court states:

"A mortgage of part of his property made by a collector of the revenue to his surety in his official bond to indemnify him from his responsibility as surety on the bond, and also to secure him from his existing and future indorsements for the mortgagor as a bank, is valid against the United States, although it turns out that the collector was unable to pay all his debts at the time the mortgage was given, and although the mortgagee knew at the time of taking the mortgage that the mortgagor was largely indebted to the United States."

In view of the facts in this case the statement of the court and its holding, upon the validity of the lien of prior mortgages as against a claim of priority on the part of the United States, can not be regarded in any sense as dictum. With respect to the character and nature of a mortgage the statement of Chief Justice Marshall is illuminating. The Hooe case involved the collection of taxes. The present claims of the United States are based upon indebtedness arising in the course of the conduct of and operation by the United States of a private business under emergency legislation. In the present case the liens of the various mortgages executed by the Minneapolis & St. Louis Railroad Company became attached and fixed many years, in one instance approximately 43 years, prior to the accruing of the debt upon which the claims of the United States are based, and further the Minneapolis & St. Louis at the time of the execution of these mortgages was not insolvent and did not become so until long after the debt due the United States originated. The assertion is made also that the opinion of the court in the Conard case to the same effect as in the Hooe case is also dictum. It may be noted, however, that one of the questions involved in the Conard case and decided by the court was the validity of the lien of a respondentia bond which was in effect a mortgage. The fact that in both the Hooe and Conard cases other

points were passed upon by the court does not eliminate the further fact that the question of the effect of a valid existing lien
36 upon the right of priority given by statute to the United States was also passed upon and decided by the court. Clearly such parts of the decision can not be regarded as dictum.

The case of Conard vs. Atlantic Insurance Company of New York, 1 Pet. 386, is one of the earlier cases dealing with the preferred right of payment by the United States under what is now section 6372 of the United States Compiled Statutes. The case was decided in 1828 and the opinion delivered by Mr. Justice Story. Mr. Justice Johnson in a separate opinion concurred. Daniel Webster was one of the counsel for defendants. This was an action of trespass brought in the Circuit Court of the United States for the District of Pennsylvania by the Atlantic Insurance Company of New York against John Conard, the United States marshal for the District of Pennsylvania, for taking and carrying away certain teas imported from Canton into the port of Philadelphia on board the ships "Addison" and "Superior." There was a plea of general issue and a special justification under a fi. fa. against the goods as the property of Edward Thomson. The facts as they appear by the record were in brief as follows:

On the 21st day of June, 1825, the plaintiffs below lent to Edward Thomson the sum of $21,000.00 upon respondentia by the "Addison," for which a bond was duly executed and delivered to the company. On the 14th of July the plaintiffs also lent to Edward Thomson the sum of $13,960.00 upon respondentia by the "Superior," for which a similar bond and memorandum and corresponding bill of lading and assignment were executed to the lenders. There was an assignment by Edward Thomson to the Atlantic Insurance Company of New York of the bills of lading. On November 19, 1925, Edward Thomson, being very largely indebted to the United States upon duty bonds, made a general assignment of all of his estate to certain persons in trust for his creditors, and on the 13th of March, 1826, he confessed judgment to the United States for one-half million dollars, upon which a fi. fa. was issued on the same day. Both shipments upon the "Addison" and "Superior" were levied upon by the marshal under the fi. fa. on the 15th of March, 1826, on the arrival of the ships, and taken into custody, where they remained until released by bond.

One of the questions involved and the only one pertinent to the present case is that of the right of preferred payment under
37 what is now section 6372, U. S. Comp. Stat. as against the respondentia loan. Mr. Justice Story in the opinion said that the real question in the case is whether the insurance company or the United States are entitled to the teas or their proceeds; the question of the validity of the respondentia bonds were discussed and decided affirmatively. After discusisng the priority statute the court inquires:

"What then is the nature of the priority thus limited and established in favor of the United States? Is it a right which supersedes and overrules the assignment of the debtor as to any property which the United States may afterwards elect to take on execution so as to prevent such property from passing by virtue of such assignment to the assignees? Or is it a mere right of prior payment out of the general funds of the debtor in the hands of the assignee? We are of opinion that it clearly falls within the latter description. The language employed is that which naturally would be employed to express such an intent, and it must be strained from its ordinary import to speak any other."

Justice Story then states:

"Then again it is contended on behalf of the United States that the priority thus created by law, if it be not of itself a lien, is still superior to any lien and even to an actual mortgage on the personal property of the debtor."

The court had previously held that the effect of the statute was not to constitute a lien upon the property in favor of the United States. The court in discussing the nature of a mortgage and the effect of the statutes asserting a priority in payment to the United States, quoted from U. S. vs. Fisher, 2 Cranch. 358, that—

"No bona fide transfer of property in the ordinary course of business is overreached by the statute."

And further:

"That a mortgage is a conveyance of property and passes it conditionally to the mortgagee."

Justice Story then goes on to state that—

"A mortgage is something called a lien for a debt. And so it certainly is, and something more; it is a transfer of the property itself as security for the debt. This must be admitted to be true at law, and it is equally true in equity, for in this respect follows the law. It is therefore only in a loose and general sense that
38 it is sometimes called a lien and then only by way of contrast to an estate absolute and indefeasible. But it has never yet been decided by this Court that the priority of the United States will divest a specific lien attached to a thing, whether it be accompanied by possession or not. Cases of lien, accompanied by possession, are among others: The lien of a ship's owner to detain goods for freight; the lien of a factor on the goods of his principal for balance due him; the lien of an artisan for work and services upon the specific thing. On the other hand, there are liens where the right is perfect, independent of possession, as the lien of a seaman for wages, and the lien of a bottomry holder of the ship for the sum loaned. In none of these cases has it ever been decided that in a conflict of satisfaction out of the thing itself the priority of the United States cut out the lien of the particular creditor."

The court then held that the respondentia bonds as given with the assignment were valid and passed the title in the cause to the

Atlantic Insurance Company of New York. In such cases the court held that the only question that properly arises in the bona fide of the transaction. The holding of the lower court that the United States had no right of priority in payment as against the respondentia loan was affirmed.

Field et al. vs. United States, 9 Pet. 182:

The relative priority of various debtors, including the United States, was in main the subject of this decision. It appears that mortgages had been given by the debtor prior to the accruing of the debt to the United States upon a part of his property which was being sold for the benefit of the creditors. Chief Justice Marshall, who delivered the opinion, said in passing upon relative priorities that—

"The priority of the latter (United States) attached by the laws of the United States, in virtue of the assignment and notice to the syndics of their debts. And it was the duty of the syndics to have made known those debts in their tableau of distribution as having such priority. There is no doubt that the mortgages upon the particular estates sold must be first paid out of the proceeds of the sales of those estates. But if there is any deficiency of the proceeds of any particular estate, to pay the mortgages thereon, the mortgagees thereof can not come in upon the funds and proceeds of the sale of the other estates, except as general creditors."

The prior rights of the United States were also passed upon in the case of Robert Y. Brent vs. Bank of Washington, 10 Pet.
39 594. Robert Brent was the holder of 659 shares of stock in the Bank of Washington and was indebted to the bank as indorser on certain promissory notes. He was also indebted to the United States as paymaster in the Army and made an assignment of his property to satisfy the debt. The assignees, however, did not accept the assignment. Shortly after he died. The bank under a provision of its charter, which gave a lien on the stock held by a debtor for the payment of debts due to them before the transfer of the stock held by a stockholder, insisted on the lien against the claim of priority by the United States, and this claim was sustained by the court. The effect and scope of the statute giving priority to the United States was considered and discussed at length, and the court said in its opinion in passing upon the lien asserted by the bank:

"It has been the uniform construction of this act, and the similar provision in the 65th section of the collection act of 1799, that whether in a case of insolvency, death, or assignment the property of the debtor passes to the assignee, executor, or administrator, the priorty of the United States operating, not to prevent the transmission of the property, but giving them a preference in payment out of the proceeds.

"This preference is in the appropriation of the debtor's estate; so that if, before it has attached, the debtor has conveyed or mort-

gaged his property, or it has been transferred in the ordinary course of business, neither are overreached by the statutes; and it has never been decided that it affects any lien, general or specific, existing when the event took place which gave the United States a claim of priority."

And the court also held that the United States coming into the court of equity for a remedy to enforce a legal right,

"must come as other suitors seeking in the administration of the law of equity, belief, to give which, courts of law are wholly incompetent on account of the legal bar imposed by the bank."

Judge Baldwin in writing the opinion also said in discussing the case:

"It is not difficult in this case to decide what the rules of good equity and conscience require. The banks have lent their money on the name, credit, and stocks of Mr. Brent, before the United
40 States could have any claim of preference. * * * In good conscience there can be no claim more equitable than that of the bank for money lent,"

and remarked that he could see no reason why the United States should be exempted from any fundamental rule of equity. In discussing the ruling in the Conard case, 1 Pet. 386, with respect to the character of the act of the debtor whether divesting his title or creating only a lien with the consequent effect as between the two upon the priority right of the United States said:

"Another rule is settled by these cases, that the priority does not attach to property legally transferred to a creditor on respondentia, though he may hold it subject to an account, equity or trust for the borrower. Such transfer will be protected against the United States, though not an out and out sale in the course of business, so as to divest the equitable as well as the legal interest of the party. Such a transaction approximates to one which merely gives a lien; its object is security, not a sale; it is in law a sale by the shape of the contract and securities, but if the goods were of greater value than the debt due, equity would compel an account for the surplus, considering the whole transaction to have been one of loan and priority merely."

In Beaston vs. Farmer's Bank of Delaware, 12 Pet. 102, it was conceded that the debtor bank was unable to pay all of its debts, but the court held that the United States was not entitled to assert its priority. The Supreme Court in course of the decision said:

"From the language employed in this section, and the construction given to it, from time to time, by this court, these rules are clearly established: First, that no lien is created by the statute; secondly, the priority established can never attach while the debtor continues the owner and in the possession of the property, although he may be unable to pay all his debts; thirdly, no evidence can be received of the insolvency of the debtor until he has been divested of his property in one of the modes stated in the section; and, fourthly, whenever he is thus divested of his property the person who becomes invested with

the title is thereby made a trustee for the United States, and is bound to pay their debt first out of the proceeds of the debtor's property."

In Saving & Loan Society vs. Multnomah County, 169 U. S. 421, it was held that—

41 "Although the right which the mortgage transfers in the land covered thereby is not the legal title, but only an equitable interest and by way of security for the debt, this interest, like any other interest, legal or equitable, may be taxed to its owner, whether resident or nonresident of the State where the land is situated, without contravening any provision of the United States Constitution."

In the opinion by Mr. Justice Gray the nature of a mortgage is considered, and in connection with the determination of its exact character he said:

"This court has always held that a mortgage of real estate, made in good faith by a debtor to secure a private debt, is a conveyance of such an interest in the land as will defeat the priority given to the United States by act of Congress in the distribution of the debtor's estate."

The case was argued October 29, 1897. Decided March 7, 1898.

In Hutchins vs. King, 68 U. S. 1 Wallace, 53, Mr. Justice Field said in delivering the opinion of the court:

"That the interest of the mortgagee is now generally treated by the courts as owner of real estate only so far as it may be necessary to give him the full benefit of the security."

In the Multnomah case cited above reference is made to an action of ejectment, commenced in the Circuit Court of the United States for the District of Pennsylvania and where Mr. Justice Strong, delivering the unanimous opinion of this court, said:

"It is true that a mortgage is in substance but a security for a debt, or an obligation, to which it is collateral. As between the mortgagor and all others than the mortgagee, it is a lien, a security, and not an estate. But as between the parties to the instrument, or their privies, it is a grant which operates to transmit the legal title to the mortgagee, and leaves the mortgagor only a right to redeem. Courts of equity," he went on to say, "as well as courts of law, have always regarded the legal title to be in the mortgagee until redemption, and bills to redeem are entertained upon the principle that the mortgagee holds for the mortgagor when the debt secured by the mortgagor has been paid or tendered. And such is the law of Pennsylvania. There, as elsewhere, the mortgagee, after breach of the condition, may enter or maintain ejectment for the land."

42 Marshall vs. People of State of New York, 254 U. S. 380.

In this case the priority of the State of New York for an unpaid annual franchise tax was involved. The State asserted that the taxes as they accrued became a lien on the property of the defendant corporation and it was entitled to priority in payment out of the assets of the corporation in the hands of a receiver. The basis of this

claim was the sovereign prerogative existing under the common law and exercised by the State of New York continuously since the Revolution. As to the various classes of creditors affected by this priority with respect to secured creditors the court in its opinion, Mr. Justice Brandeis, said:

"The propriety of allowing to the State a preference as to amounts due for the annual franchise taxes is admitted by the receiver. No question of the relative priority of the State and the United States is involved. Nor does any question arise as to priority of the State over incumbrances. The single question is presented whether the State of New York has priority in payment out of the general assets of the debtor over other creditors whose claims are not secured by act of the parties nor accorded a preference, by reason of their nature, by the State legislature or otherwise."

In this case the court, also in discussing the priority right, of the State of New York, as a sovereign and prerogative right, said:

"At common law the crown of Great Britain, by virtue of a prerogative right, had priority over all the subjects for the payment out of a debtor's property of all debts due it. The priority was effective alike whether the property remained in the hands of the debtor, or had been placed in the possession of a third person, or was in custodia legis. The priority could be defeated or postponed only through the passing of title to the debtor's property, absolutely or by way of lien, before the sovereign sought to enforce his right."

The Supreme Court followed the New York ruling that the State of New York had succeeded to the common-law rights of the crown, and again in discussing the question of priority the court said:

"Whether the priority enjoyed by the State of New York is a prerogative right or merely a rule of administration is a matter of local law * * *." Citing cases.

Case of Jacob Richardson, collector at Oswego, 9 Op. Atty. Gen. 28:

43 1. The act of 1797, which provides that when the estate of a deceased debtor to the United States is insufficient to pay all his debts, the debt due to the Governemnt shall be first satisfied, does not create any lien upon the debtor's property, but merely points out a mode of distribution.

2. The priority of the United States, therefore, can not reach back over any valid lien, whether it be general or specific.

3. Where a collector of customs executed a mortgage upon his real estate to indemnify his sureties, and then died insolvent and in debt to the United States, the mortgage to the sureties is valid and effectual against the United States.

ATTORNEY GENERAL'S OFFICE,
May 16, 1857.

SIR: Jacob Richardson, late collector for the port of Oswego, N. Y., dies in 1854, insolvent, and largely indebted to the United

States. Before his death, and after his default, he executed a mortgage of real estate to his sureties for their indemnity. Have the mortgagees a right to the proceeds of the mortgaged estate in preference to the United States?

By the act of March 3, 1797 (1 Stat. at Large 515), it is provided that when the estate of a deceased debtor to the United States is insufficient to pay all his debts the debt due to the Government shall be first paid and satisfied. This does not create any lien upon the debtor's property, but merely points out a mode of distribution, just as, in most of the States, funeral expenses, servants' wages, and physicians' bills are preferred to other claims. (Fisher vs. Blight, 2 Cr. 358.)

In one case (Theluson vs. Smith, 2 Wheat. 396) it is said that the act of Congress defeats the preference to which a judgment would otherwise be entitled by virtue of its general lien on the debtor's property. This was afterwards pronounced a mere dictum of the judge who delivered the opinion (Conrad vs. The Insurance Co., 1 Peters, 386). It has been distinctly overruled, and by the later cases it seems to be well settled that the priority of the United States will not reach back over any lien, whether it be general or specific. (Brent vs. The Bank, 10 Peters, 596; Clark vs. White, 12 Peters, 182; McLean vs. Rankin, 3 Johnson, 369; The United States vs. Nicholls, 4 Yeates, 251; Wilcocks vs. Waler, 10 S. & R. 380; The United States vs. The Mechanics' Bank, 1 Gilpin, 49.)

44 But the acts of Congress giving the United States priority in the distribution of the effects of a public debtor have never been so construed as to make them displace the specific lien of a mortgage upon land, any more than to invalidate a bona fide sale.

A mortgage to secure future advances which the mortgagee has obliged himself to make or to indemnify against liabilities, as surety or otherwise, which the mortgagee was previously bound to incur, is a good and valid mortgage.

It is useless, however, to discuss the general principles of the question you submit, or to collate cases on the subject which are merely analogous, when there is one in the books decided by the highest authority and directly to the point. In the United States vs. Hooe (3 Cranch, 73) it was held that a mortgage made by a collector of revenue to his surety in his official bond to indemnify him from his responsibility on the bond, and from other liabilities, is valid, although the collector was insolvent and the mortgagee at the date of the mortgage knew him to be largely indebted to the United States.

I am of opinion that, under the circumstances of this case, the United States can not legally claim to be paid out of the proceeds of the mortgaged premises in preference to the mortgagees.

Very respectfully yours, etc.,

J. S. BLACK.

Hon. P. CLAYTON,
Acting Secretary of the Treasury.

United States vs. Canal Bank, Federal Case No. 14715.

Opinion by Story, Chief Justice; it is said in the opinion:

"In the first place whether the United States have any priority or preference in respect to the debts due to them by their debtors over the debts due to private persons so as to entitle them to a priority satisfaction upon any judgments obtained against their debtors out of the property attached before other attaching creditors whose attachments are of an earlier date. In my judgment they have not. * * * The case of Prince vs. Bartlette, 8 Cranch, 431, is directly in point in the case of conflicting attachments and decides that in such a case the private creditor having the priority
45 attachment on the property is entitled to a preference over the subsequent attachment of the United States."

and the syllabus of the decision states,

"the United States have no such priority over other creditors of their debtor as to entitle them to a prior satisfaction, by attachment and levy, over prior attaching creditors."

United States vs. Delaware Insurance Company, Federal Case No. 14942. The opinion in this case was written by Washington, circuit judge, and it holds,

"that if before the right of preference of the United States to be first paid out of the estate of the insolvent as accrued, by the act of insolvency being committed, the debtor has made a bona fide conveyance to properties of a second person or has mortgaged or it has been taken in execution, such property is not liable for the debt due to the United States."

United States vs. Mechanics' Bank, Federal Case No. 15756. Hopkinson, district judge, held in this case that the priority of the United States under section 3466. U. S. Rev. Stat., gave no lien on property under execution when it accrued.

United States vs. Sheriff of Charleston, Federal Case No. 16276.

In construing the various acts giving a preference to the United States, notably that of August 4, 1790, May 2, 1792, and March 3, 1797, the court said:

"I can not find that these acts do in any manner comprehend the present case; there is not a syllable in either of them that can be fairly construed to divest a prior legal lien."

And the case stated in the syllabus as supporting the doctrine that the revenue law of the United States gave a preference over other creditors in several cases but must not be construed as destroying prior legal lien.

United States vs. Duncan, 4 McLean, 607, 25 Fed. Case No. 15003.

In this case, which involved the priorities of the United States under section 3466, U. S. Rev. Stat., the court held that it had been the uniform holding in all cases that the priorities of the United States do not disturb any specific liens nor the perfected lien of a

judgment; that is, it does not supersede a mortgage on land, nor
46 a judgment made perfected by the issue of an execution and a levy on real estate. In the case of a general lien the court held the rule was not so clear. In the course of the litigation through which the United States sought to collect from Duncan, who had become one of the sureties upon one Lin who was receiver of public moneys at Vandalia and who had been in default to a large extent, judgments had been obtained against Duncan. The decree in one of these cases ordered that the real estate of Duncan be sold and the proceeds to be paid to the United States, "first paying prior liens, if any."

United States vs. Griswold et al., 8 Fed. 496.

In this case it was held that a debtor of the United States may assign his property within the meaning of section 3466, U. S. Rev. Stat., by means of judgment, confessed in favor of various persons for amounts equal in the aggregate to the value thereof, and the priority of the United States will thereupon attach to the property and prevail against said judgments but subject to all prior valid liens thereon. One of the liens was a mortgage on some of the real property of the debtor. An attempt was made to establish this transaction as fraudulent but the court said:

"The mortgage is allowed to stand as a valid lien on the property for the amount loaned thereon, with interest, less the amount paid thereon by Griswold—$325.80—and the priority of the United States must be enforced subject thereto."

In the case of Schmidtman vs. Atlantic Phosphate & Oil Corporation, 230 Fed. 769, the court in considering preference rights of employees and laborers established by the wage law of New York over other creditors said:

"In construing a statute like this, it is a safe rule for the Federal courts to follow, by analogy, the construction given by the United States Supreme Court to section 6372, U. S. Comp. Stat. (3466 U. S. Rev. Stat.), originally passed in 1799. (Act March 2, 1899, c. 22, sec. 65.) That section gives to the United States, on the death of an insolvent debtor whose estate is not sufficient to pay 'all debts due from him' a priority of payment, declaring that the 'debts due to the United States shall be first satisfied.' Interpreting this statute literally and upon the theory that a sum due under a mortgage is a debt under the statute, then the courts should have held that the Government's debt is to be satisfied before the debt secured by a mortgage. But the Supreme Court has held otherwise con-
47 sistently from the beginning, having laid down the rule in Conard vs. Atlantic Insurance Company, 1 Pet. 386, 7 L. Ed. 189, in an opinion written by Justice Story, that the statute gives a mere right to prior payment out of the general funds of the debtor and that it does not take precedence over a mortgage debt. It is just as true now as it was then that the Supreme Court has never yet decided that the priority the statute gives divests a specific lien."

Another case might be cited with advantage from the eighth circuit—namely, City and County of Denver vs. Stenger, 295 Fed. 809. The decision was written by Stone, circuit judge. One of the questions decided was that of the preferential status of a claim filed by the city and county of Denver for an arrears of $20,000.00 in the payment of a so-called franchise tax. The exact provision requiring this obligation was included in a franchise passed in 1906 covering the relations between the city and county of Denver and the Denver City Tramway Company and in which it was agreed that the Tramway Company should "pay to the city and county of Denver the sum of one million two hundred thousand dollars ($1,200,000.00) payable in equal installments of $5,000.00 each on the first of each and every calendar month during the life of this franchise." The city and county of Denver claimed that the obligation was money due the sovereign and attendant with the right to preferential payment attaching under the common law, a debt due the sovereign. It was contended that although such payments were not taxes in an exact technical sense, yet they were "in the nature of" taxes and entitled to a priority as such. Upon this point the court decided that the priority of taxes as such due prior to receivership results from lien rights established by statute, and although the receivership proceedings will not be permitted to defeat this statutory priority, yet the lien "will neither be created by implication nor enlarged by construction. We think no priority has been shown based on the theory of a tax or of a payment in the nature of a tax." And again, in answer to the claim of priority of the city and county of Denver as stated above, the court said, on page 816:

"The fourth contention, that the preference sovereign is lost when specific liens exist in advance of the assertion of the preference by the sovereign, is stated too broadly. This preference given by the common law was an inchoate right which attached only from and as of the time when it was properly claimed or asserted
48 and did not affect or take precedence over liens which were fixed upon the property prior to that time and were then in force. Marshall vs. New York, 254 U. S. 380, 384, 41 Sup. Ct. 143, 65 L. Ed. 315; The King vs. Watson, 3 Price 6; Rex vs. Lee, 6 Price 369; excellent note, with citations, 29 L. R. A. 245; also 1 L. R. A. (N. S.) 255, note.

"Applying the above consideration to that portion of the claim accruing before the receivership results in allowance thereof with a preference in payment next following claims carrying liens which had attached at the time appellant filed his application."

Kennebec Box Company vs. O. S. Richardson Corporation, 5 Fed. (2d) 951. Expenses of receivership of insolvent estates have priority over taxes due United States, not secured by lien under Rev. Stat. 3186, notwithstanding section 3466, since there is no fund for payment of insolvent's debts until receivership expenses are paid. The court said:

"For purposes of argument only it may be admitted that out of any fund available for paying the debts of an insolvent debtor United States taxes are to be paid first and in full. But it is elementary that what is available to pay the debts of any debtor must be the property of that debtor."

In this case there were no funds left for the payment of any debts after liquidation of receivership expenses.

In re Caswell Construction Company, Inc., 13 Fed. (2d) 667. This case involved the question in point arising under a petition by mechanics' lienors for an order directing the trustees in bankruptcy to pay their liens before paying the claim of the United States for income taxes. The court held that the mechanic's lien was not subordinate to a later assessed Federal income tax. The case arises under the bankruptcy act, but the discussion of the priority of the United States is general in its scope. The court said:

"Whatever be the law as to the status of taxes of the United States as an attribute of sovereignty or as existing at common law, it is clear that the United States may limit its priority by statute when it does so expressly, and this it has done by sections 3466 and 3186 of the Revised Statutes, Comp. Stat., sec. 6372, 5908, and sections 64a and 67d of the bankruptcy law."

The court then held that as to estates in bankruptcy the bankruptcy act superseded section 3466, Rev. Stat. In discussing generally the question of priority the court said:

49 "A receiver appointed by a Federal court takes the property subject to all liens, property, and privileges existing or accruing under the laws of the States." (Citing cases.)

And again, quoting from United States vs. Lewis, Federal Case No. 15595, where it was said:

"The claim of the Government extends only to that which was the property of the debtor when he became insolvent, and his property is only that in substance, which remains after the satisfaction of liens upon it." Citing Prince vs. Bartlett, 8 Cranch, 431; U. S. vs. Canal Bank, Federal Case No. 14715.)

Upon the effect of a judgment as a lien superseding the priority of the United States as given in section 3466, U. S. Rev. Stat., the case of Thelusson vs. Smith, 2 Wheaton 396, is cited as not superseding that priority.

In Conard vs. The Atlantic Insurance Company of New York, 1 Peters 386, 444, the case of Thelusson vs. Smith, 2 Wheaton 396 was explained and distinguished. In the Conard case Mr. Justice Story, writing the decision, said:

"It is admitted that where any absolute conveyance is made, the property passes so as to defeat the priority; but it is said that a lien has been decided to have no such effect, and that in the eye of a court of equity a mortgage is but a lien for a debt. Thelusson vs. Smith has been mainly relied upon in support of this doctrine. This case has been greatly misunderstood at the bar and will require a particular explanation."

In the course of this explanation and on page 444, Justice Story said:

"The real ground of the decision was that the judgment creditor had never perfected his title by any execution and levy on the Sedgely estate; that he had acquired no title to the proceeds as his property, and that if the proceeds were to be deemed general funds of the debtor, the priority of the United States to payment had attached against all other creditors; and that a mere potential lien on land did not carry a legal title to the proceeds of a sale made under an adverse execution. This is the manner in which this case has been understood by the judges who concurred in the decision; and it is obvious that it established no such proposition as that a specific and perfected lien can be displaced by the mere priority of the United States, since that priority is not of itself equivalent to a lien."

The language of the priority statute the benefit of which is invoked by the United States is that the debts due the United States must first be satisfied out of the estate of the debtor, and the recurring, constant question arises: What is the estate of the debtor? And the answer, as constant and recurring as the question, is, namely, that which the debtor owns at the time of his insolvency. It is clear beyond doubt that the property of others can not be taken to satisfy the debts of the United States, for that would be a confiscation which would not be tolerated now, nor was it tolerated even in the later days of the King's prerogative.

Construction of analogous statutes

The indebtedness claimed to be due and owing the United States of America from the Minneapolis & St. Louis Railroad Company and constituting the basis of the claims (except two, one withdrawn and the other a fine of $100.00) filed by the Government in Consolidated Cause 290 with 299 in equity, originate entirely in financial transactions growing out of the use and operation of the railroad company by the Government during the period of Federal control, so called, or within the time prescribed by law after the end of that control. Such control dependent absolutely upon the emergency legislation with which all are familiar. The acts of Congress under which carriers were controlled by the Government prescribed in great detail their operation, the settlement and adjustment of mutual accounts, with other provisions for the reimbursement of the United States for necessary disbursements through the sale of securities and obligations issued by the carriers and others, and from their net operating income.

It has been held by the Supreme Court of the United States that the priority provisions in favor of the Government to be found in the national bankruptcy act and the old national banking legislation superseded the preference given under section 3466 of the U. S. Rev.

Stat. or 6372, U. S. Comp. Stat. It is urged that such priority is also superseded by the manifold and various provisions to be found in the Federal control legislation which, as already stated, provided in detail for the advancement of moneys and acceptance of securities issued by common carriers in payment.

In order to pass upon this point intelligently a short review of the Federal control legislation will be made.

51 The first provision relative to the subject in question is to be found in the Army appropriation act of August 29, 1916, 39 Stat. L. 645, where the President was authorized and empowered in time of war,

"to take possession and assume control of any system or systems of transportation, or any part thereof, and to utilize the same, to the exclusion as far as may be necessary of all other traffic thereon, for the transfer or transportation of troops, war material, and equipment, or for such other purposes connected with the emergency as may be needful or desirable."

March 21, 1918, the original Federal control act was passed and it is entitled,

"An act, to provide for the operation of transportation systems while under Federal control, for the just compensation of their owners, and for other purposes."

This act recites in section 1 that the President, having in time of war taken over the possession, use, control, and operation of certain railroads, is authorized to agree with and to guarantee to any such carrier that during the period of such Federal control they shall receive as just compensation an annual sum not to exceed the average annual railway operating income for the three years ending June 30, 1917.

The fourth paragraph of this section provides for—

"maintenance, repairs, renewals, and depreciation,"

and further,

"That the United States may, by deductions or by other proper means and charges, be reimbursed for the cost of any additions, repairs, renewals, and betterments to such properties not justly chargeable to the United States."

By paragraph seven of this section the provisions of the act are extended to competing or connecting railroads, and the law provides that these shall be held and considered as within Federal control as herein defined, and necessary for the prosecution of the war, and shall be entitled to the benefit of all the provisions of this act.

Section 6, as amended March 2, 1919, provides for the appropriation of $500,000,000 out of any moneys in the Treasury not otherwise appropriated, which, together with any funds available from any operating income of said carriers, may be used by the President as a revolving fund for the purpose of paying the ex-

52 penses of Federal control, and so far as necessary the amount of just compensation, and to provide terminals, motive power, cars, and other necessary equipment.

It was provided in the second paragraph of this section:

"The President might order betterments, and extensions made, and that from this revolving fund he might advance to a carrier all or any part of the expense of such additions, betterments, or road extensions, such advances to be charged against such carrier and to bear interest at such rate and be payable on such terms as may be determined by the President, to the end that the United States may be fully reimbursed for any sums so advanced."

The President was also authorized to utilize and operate water facilities.

Section 7 provides—

"That for the purpose of providing funds requisite for maturing obligations or for other legal proper expenditures, or for reorganizing railroads in receivership, carriers may during the period of Federal control issue such bonds, notes, equipment trust certificates, stock, and other forms of securities, secured or unsecured by mortgage, as the President may first approve as consistent with the public interest."

It was also provided in this section that the President might out of the revolving fund created by this act purchase for the United States all or any part of such securities, at prices not exceeding par, and might sell such securities whenever in his judgment it was desirable at prices not less than the cost thereof.

"Any securities so purchased shall be held by the Secretary of the Treasury, who shall, under the direction of the President, represent the United States in all matters in connection therewith in the same manner as a private holder thereof."

The first paragraph in section 10 provides—

"That carriers while under Federal control shall be subject to all laws and liabilities as common carriers, whether arising under State or Federal laws, or at common law, except in so far as may be inconsistent with the provisions of this act or any other act applicable to such Federal control, or with any order of the President. Actions at law or suits in equity may be brought by and against such carriers and judgments rendered as now provided by
53 law; and in any action at law or suit in equity against the carriers no defense shall be made thereto upon the ground that the carrier is an instrumentality or agency of the Federal Government. Nor shall any such carrier be entitled to have transferred to a Federal court any action heretofore or hereafter instituted by or against it, which action was not so transferable prior to the Federal control of such carrier; and any action which has heretofore been so transferred because of such Federal control or of any act of Congress or official order or proclamation relating thereto shall upon motion of either party be retransferred to the court in which it was originally instituted. But no process, mesne or final, shall be levied against any property under such Federal control."

In section 12 it was provided that the moneys and other properties derived from the operation of the carriers during Federal control

should be the property of the United States, but that unless directed by the President such moneys should not be covered into the Treasury, but should remain in the custody of the same officers, and accounting thereof should be in the same manner and form as before the Federal control and that disbursements therefrom should without further appropriation be made in the same manner as before Federal control.

The last paragraph of this section provided that—

"At such periods as the President may direct, the books shall be closed and the balance of revenues over disbursements shall be covered into the Treasury of the United States to the credit of the revolving fund created by this act. If such revenues are insufficient to meet such disbursements, the deficit shall be paid out of such revolving fund in such manner as the President may direct."

The accounting by the carrier is to be made in the same manner as before Federal control and according to the classification of accounts prescribed by the Interstate Commerce Commission.

Section 15 of the act provided—

"That this act is expressly declared to be emergency legislation enacted to meet conditions growing out of war; and nothing herein is to be construed as expressing or prejudicing the future policy of the Federal Government concerning the ownership, control, or regulation of carriers, or the method or basis of the capitalization thereof."

54 November 19, 1919, an act was passed to provide for the reimbursement of the United States for motive power, cars, and other equipment ordered for railroads and systems of transportation under Federal control, and for other purposes. This act in part authorized the purchase of equipment under equipment trust agreements, so called, and it provided that the President might upon such terms as he should deem advisable receive in reimbursement, cash or obligations of any carrier, or part cash and part such obligations, or in his discretion he might accept for such motive power, cars, or other equipment cash or the shares of stock or obligations secured or unsecured, of any corporation not a carrier organized for the purpose of owning equipment or equipment obligations, or part cash and part such shares of stock and obligations, and that he might transfer to such corporation any obligations of carriers received on account of motive power, cars, or other equipment. It was expressly provided that such agreements and transactions should be

"to the end that title to the motive power, cars, and other equipment so ordered by the President as aforesaid for the carriers may rest in them or their trustees or nominees."

The last section of the act provided that this act is emergency legislation enacted to meet conditions growing out of war and to effectuate said act of March 21, 1918.

February 28, 1920, Congress passed an act terminating Federal control of railroads and systems of transportation. This act provided that Federal control should terminate at 12.01 a. m. March

1, 1920. It provided in section 207 for the refunding of carriers' indebtedness to the United States. In subdivision (b), section 207, it was provided that—

"Any carrier obtaining the refunding of such indebtedness as aforesaid shall give, in the discretion of the President, such security, in such form and upon such terms as he may prescribe."

In subdivision (d) it was provided that—

"Any other indebtedness of such carrier to the United States which might exist after the settlement of accounts between the United States and the carrier and which was then due should be evidenced by notes payable in one year from the termination of Federal control or a shorter period at the option of the carrier, with interest at the rate of 6% per annum" to be secured by such collateral security as the President might deem it advisable to require.

55 Provision was made in subdivision (e) for the extension of obligations.

In section 210, as amended June 5, 1920, provision was made for the making of new loans to railroad companies. In subdivision (a) of this section it was provided—

"For the purpose of enabling carriers by railroad subject to the interstate commerce act properly to serve the public during the transition period immediately following the termination of Federal control, any such carrier may, at any time after the passage of this act and before the expiration of two years after the termination of Federal control, make application to the commission for a loan from the United States to meet its maturing indebtedness, or to provide itself with equipment or other additions and betterments, setting forth the amount of the loan; the term for which it is desired; the purpose of the loan and the use to which it will be applied; the present and prospective ability of the applicant to repay the loan and meet the requirements of its obligations in that regard; the character and value of the security offered; and the extent to which the public convenience and necessity will be served."

Subdivision (b) of this section prescribed the details of the procedure in respect to the application, hearing upon and granting of the loan, and it refers to a hearing and investigation by the Interstate Commerce Commission with or without notice to determine the "prospective earning power of the applicant" and if the character and value of the security offered was such as to furnish reasonable assurance of the applicant's ability to repay the loan within the time fixed therefor and to meet its other bonds in connection with such loan.

Subdivision (c) of the section provided that the Secretary of the Treasury upon the receipt of the certificate provided for from the Interstate Commerce Commission should immediately or as soon as practicable, "make a loan of the amount recommended in such certificate out of any funds in the revolving fund provided for in

this section and accept the security prescribed therefor by the commission."

In subdivision (e) an additional appropriation was made of $300,000,000 as a revolving fund for the purpose of making the loans provided for in section 210 and for paying the judgments, decrees, and awards referred to in subdivision (e), section 206. This section refers as a basis for the loan to the prospective earning
56 power of the applicant, the character and value of the security offered and the applicant's ability to repay the loan within the time fixed therefor. The Interstate Commerce Commission was required, after investigation and hearing, to make findings upon these facts and to give their opinion as to these facts, and it was further required to render an opinion with respect to "reasonable assurance of the applicant's ability to repay the loan within the time fixed therefor and reasonable protection to the United States." It also required a certificate from the commission that the applicant in its opinion was unable to provide itself with the funds necessary for the aforesaid purpose from other sources. The purpose of this section as stated in subdivision (a) was to enable carriers "to properly serve the public during the transition period immediately following the termination of Federal control."

To accomplish the objects stated in the various laws relating to Federal control and its termination, revolving funds were created by Congress consisting of $500,000,000 as provided in the original law and the further sums of $200,000,000 and $300,000,000, making a total of $1,000,000,000 in the revolving fund. In this revolving fund, in addition to the sums so appropriated the surplus income of the carriers was placed as prescribed in the original law.

The Supreme Court said in Mellon, Director General, vs. Michigan Trust Company, that all agree that the rights of the director general rest upon statutory provisions and not upon any sovereign prerogative of the United States and further that in some matters at least under section 10 of the act of 1918 the United States stands exactly as if they were a railroad corporation operating as a common carrier. Very few cases have been decided passing upon the question of priorities of the Government under the Federal control acts. There were some earlier decisions in the Circuit Court of Appeals favorable to such priorities, but upon a substantially similar state of facts these have been reversed by the ruling of the Supreme Court in the Mellon case. Attention will be called to the very few cases thus decided.

Director General of Railroads vs. Kastenbaum, 263 U. S. 25. This is an action brought by Samuel Kastenbaum against the Director General of Railroads, seeking damages for false imprisonment and malicious prosecution. There was a judgment for plaintiff in the New York State courts and certiorari to the Supreme Court of the United States. The judgment of the lower court was
57 affirmed. Section 10 of Federal control act was cited, and in the opinion by Mr. Chief Justice Taft it was held that the

Government under section 10, in a case of false imprisonment, "stands exactly as if it were a railway corporation operating as a common carrier * * *. If in the field of such employment the agent acts without probable cause and an illegal arrest without judicial warrant is made, the corporation is liable for any other act of its agents within the scope of their employment in carrying on the business of a common carrier."

Davis vs. Pringle, 268 U. S. 315. Three cases were involved in this appeal. The first and second were claims for freight, storage, and demurrage proved in bankruptcy proceedings by a Federal agent, for which the agent asserted priority on the ground that such claims arising during Federal control of the railroads in 1918 were debts due to the United States and were preferred by section 3466, U. S. Rev. Stat., and by the bankruptcy act of July 1, 1898, as amended. The third was a claim by the United States for amounts paid by the Postmaster General to the bankrupt for bills of exchange and checks drawn by the bankrupt and unpaid, together with protest fees, etc., as to which priority was asserted on the same grounds. The priority was denied in the first two cases by the Circuit Court of Appeals for the Fourth Circuit Court and not allowed in the third case. The Supreme Court of the United States denied priority in all cases, affirming the decision in the first two and reversing the third. The contention was made on the part of the United States that the bankruptcy act with its amendments was sufficient to entitle the United States to a priority as well as under section 3466, U. S. Rev. Stat. The Supreme Court in its opinion written by Mr. Justice Holmes discussed the change in the bankruptcy law relative to the governmental priorities and commented to the effect that such priorities were larger in the earlier acts and more "comprehensive."

Mr. Justice Holmes then said:

"Public opinion as to the peculiar rights and preferences due to the sovereign has changed. We agree with the view of this point taken by the Chief Justice and Justices Vandevanter and Clarke in United States Shipping Board Emergency Fleet Corporation vs. Wood, 258 U. S. 549, at the time when it was not necessary for the majority to speak upon it. The priority claimed by the United States is not given to it by the law."

58 Mellon, Director General, vs. Michigan Trust Company, 271 U. S. 236. The unanimous opinion of the court was delivered by Mr. Justice McReynolds. The facts as stated in the opinion are briefly as follows: Creditors of the Rathbone Manufacturing Company filed a bill against it in which they alleged its inability to pay lawful debts in due course of business and asked for a receiver. The answer of the corporation admitted the allegations and gave consent to the relief prayed. Thereupon the Michigan Trust Company was appointed receiver and took possession of the property. The Director General of Railroads presented

in the receivership proceedings claims for transportation charges and conversion of a shipment of pig iron. He asked for priority of payment under section 3466, which was denied both in the trial court and in the Circuit Court of Appeals, where the decision is reported under Davis, Director General, vs. Michigan Trust Company, 2 Fed. (2d) 194. The court held first that, as pointed out in the Butterworth-Judson Corporation case, 269 U. S. 504, the things done by the Rathbone Manufacturing Company amounted in substance to a voluntary assignment of all of its property within the meaning of section 3466, U. S. Rev. Stat. The court also held that under Davis vs. Pringle, 268 U. S. 315, as the estate of the Rathbone Manufacturing Company was being administered under the bankruptcy act the claims of the director general would not be entitled to a preference and then said that the decision in the case before the court must turn upon the effect to be given section 10, act of March 21, 1918, chap. 25, 40 Stat. 451. The court then continues as follows:

"All agree that the rights of the director general rest upon statutory provisions, and not upon any sovereign prerogative of the United States. In taking over and operating the railroads the United States acted in their sovereign capacity. Du Pont de Nemours & Co. vs. Davis, 264 U. S. 456, 462, 44 S. Ct. 364, 66 L. Ed. 788. But it was for Congress to determine whether or not claims arising out of such operation should have priority when the debtor made a voluntary assignment. In cases of bankruptcy the statute then in force prohibited any preference.

"In some matters, at least, under section 10, the United States stand exactly as if they were a railroad corporation operating as a common carrier. Director General vs. Kastenbaum, 263 U. S. 25, 28, 44 S. Ct. 52, 68 L. Ed. 146. As said in Davis vs. Pullen (C. C. A.), 277 F. 650, 655:

59 "'There is a certain obvious injustice in giving the United States when engaged in an industrial and commercial venture, even although under war powers, superior rights over other creditors bearing like relations to insolvents.'

"And we think that the indicated purpose of Congress will be best carried out by construing the relevant statutes, so far as may be, iwth the general intent to preserve the substantive rights of all parties concerned as they would have existed but for Federal control.

"Section 10 subjected the director general, as an operator of common carriers, to the laws theretofore applicable to them, except when inconsistent with some provisions of the Federal control acts or an order of the President, and forbade him to defend, in any suit against him as such operator, upon the ground that he was an instrumentality or agency of the Federal Government. In the circumstances presented by this record it is reasonable to say that the statute confined his substantive rights to those which a carrier would have had, and prohibits him, as though he were an actual defendant

in a suit, from resisting the demands of others for equal distribution of the insolvent's assets, under the commonly applied rule, upon the ground that he is an instrumentality of the Federal Government. To permit the claimed preference, we think, would conflict with the spirit and broad purpose of the statute. These become plain enough upon consideration of the just ends which Congress had in view, together with the recent policy revealed by the bankruptcy act in respect of priorities."

Davis, Director General, vs. Michigan Trust Company Case, 2 Fed. (2d) 194. This case was an appeal from a decree of the District Court denying priority for the Government in claim filed by the director general for freight, demurrage, and switching charges in the distribution of the assets, in the hands of a receiver in equity, of the Rathbone Manufacturing Company. The claim of the director general for priority was based upon section 3466 U. S. Rev. Stat., 6372 U. S. Comp. Stat. This case was affirmed in Mellon, Director General, vs. Michigan Trust Company, 271 U. S. 236, 46 Sup. Ct. Rep. 511. The discussion of the question of priority is so thorough and complete that that part of the decision bearing upon it is given in full.

"A final question remains:

(2) Third. Does section 10 of the Federal control act (40 Stat., March 21, 1918, c. 25, Comp. St., 1918 Comp. St. Ann., 60 Supp. 1919, par. 3115¾ j) prevent the director general from asserting Government priority over other creditors on claims arising out of the governmental war operations of the railroads?

It seems to us clear that this section was intended to subject the director general in the operation of the various railway systems of the same rules of substantive civil law that had therefore applied to the carriers. To give the director general, with his manifold claims arising in the ordinary course of business, priority over all other creditors may work grave injustice. In some cases it might result in the director general's taking all or nearly all the assets of the debtor. Such priority would give to the director general a special and privileged position quite inconsistent with the underlying principles of the Federal control act (Director General vs. Kastenbaum, 263 U. S. 25, 44 S. Ct. 52; Davis vs. McCree, 299 F. 142, 146 (C. C. A. 6); and the marked tendencies of our public law; cf. The Pesaro (D. C.), 277 F. 473; The Gloria (D. C.), 286 F. 188. Judicial opinion as well as legislation is examining anew the proper privileges and immunities to be accorded the sovereign State, and in cases not clearly covered by statute or decision the correct solution is not to be found by the application of an abstract formula, but by the most careful consideration of the public needs and the practical requirements of law in the modern industrial community.

Giving due regard to the expression of congressional policy of priority, on the one hand, and a restriction to the rights that the carriers theretofor enjoyed, on the other hand, and on a careful

balancing of conflicting interests, we believe that, especially in the light of the policy of the present bankruptcy act as interpreted by the Chief Justice, supra, priority must be denied the director general in this case. The question of priority is a matter of civil, compensatory law like the question of tort liability, considered in the Kastenbaum case, supra, and is quite different from the question of the nonliability of the director general, dealt with in Missouri Pacific R. R. Co. vs. Ault, 256 U. S. 554, 41 S. Ct. 593, 65 L. Ed. 1087. It is also to be distinguished from the question whether the director general is subject to the Special State and Federal statutes of limitations. Du Pont de Nemours & Co. vs. Davis, 264 U. S. 456, 44 S. Ct. 364, 68 L. Ed. 788; Davis vs. Corona Coal Co., 265 U. S. 218, 44 S. Ct. 552, 68 L. Ed. 987. The fact that the director general has
61 been declared not to have been subjected to the limitation statutes renders it all the more important that the declared legislative policy subjecting him to the usual rules of substantive civil law be given full effect. While our conclusion differs from that expressed in in re Hibner Oil Co., 264 F. 667, 14 A. L. R. 629 (C. C. A. 7), and in re Tidewater Coal Exchange, 280 F. 648 (C. C. A. 2), as well as in Davis vs. Pollen and Davis vs. Miller Link Lumber Co., supra, in none of these cases does the court's attention appear to have been drawn to section 10 of the Federal control act. Affirmed."

Basis of claims conduct of private business

The claims in question are urged for payment by the United States as a sovereign State. And they are based upon the transactions of the Government between itself and a common carrier. The business of transportation is private in its character, and the operations out of which the debt originated were carried on at a time when the Government, under emergency legislation, had forcibly seized the private business of transportation in the United States and was conducting the war in which it was then engaged.

The United States is a sovereign State and as such under all constitutional theories of government is limited in its operations to the exercise of governmental powers and the performance of governmental functions. And as said by the Circuit Court of Appeals in the case of Davis vs. Michigan Trust Company, 2 Fed. (2d), 194:

"Judicial opinion as well as legislation is examining anew the proper privileges and immunities to be accorded the sovereign State, and in cases not clearly covered by statute or decision the correct solution is not to be found by the application of an abstract formula, but by the most careful consideration of the public needs and the practical requirements of law in the modern industrial community."

To determine the scope of the statutes in question giving priority to the United States, the intent and purpose of the statute should be ascertained, and that intent and purpose is determined by the limitations, express and implied, upon the power of the Government

to act. That the original intent of the statute was to apply to the collection of taxes is clearly apparent from the fact that until the few cases were decided arising out of transactions under the Federal control act, substantially all of the cases passing upon the question of priority involved the collection of revenue either directly or
62 indirectly in suits upon bonds given by collectors of revenue to ensure the proper disbursement by revenue officials of the moneys collected in their official capacity. The character of the debt incurred in the present instance is essentially and radically different from that of a tax. It is not denied that the power of taxation is political and governmental in its character, and it is that power most necessary to the existence and maintenance of government and the exercise of various governmental functions which are uniformly recognized as proper. All the decisions recognize the fact that with respect to taxes, either National or State, the government levying them should not be hampered either in their levy or collection. Without citing any one of numberless cases sustaining this rule, reference can be made to one of the Circuit Court of Appeals for the Eighth Circuit, State of Minnesota vs. Central Trust Company, 94 Fed. 244, where the priority of certain personal property taxes levied under the laws of Minnesota was one of the questions determined. The opinion was written by Judge Thayer. Caldwell, Sanborn and Thayer, judges sitting. Judge Thayer in the course of the decision written by him said:

"It has been held frequently that a tax lawfully imposed by the State on its citizens is not an ordinary debt, but is an obligation which by its nature should be regarded as paramount to all other demands against the taxpayer, although the law imposing the tax does not in express terms declare such priority."

And again, he said, after quoting decisions:

"These decisions also express a thought which is generally prevalent in the public mind that taxes levied by the State for its own support are founded upon a higher obligation than other demands. The fact has also been recognized from time immemorial that every sovereignty ought to be armed with the requisite power to enforce the collection of taxes without fail, and to compel the prompt payment of whatever imposts it sees fit to levy for its own support."

An important consideration in determining the asserted priority of the United States is that of the character of the business it engaged in when operating the railroads of the United States. The business of transportation has been regarded and still is so considered as essentially private in its character. This Government is not yet committed to the theory or burden of Government ownership of transportation facilities. It may have assumed the control
63 under its sovereign powers, but the actual operation was not an exercise of either its governmental functions or powers, and the fact that it so engaged in such operation could not change the character of the business from that of a private enterprise to that of a governmental function. Moreover, Congress in the original

act expressly disclaimed in the legislation any such intention as that of taking on Government ownership. The entire situation arose because of the existence of a war. The legislation was of an emergency character and so stated to be. It originated primarily in that provision of the Army appropriation act of August 29, 1916, when Congress declared that the President in time of war was empowered, through the Secretary of War, to take possession and assume control of systems of transportation or any part thereof. For what purpose? "To utilize the same, to the exclusion as far as may be necessary of all other traffic thereon, for the transfer or transportation of troops, war material, and equipment, or for such other purposes connected with the emergency as may be needful or desirable."

The Government engaged in the operation of railroads exactly as if it were their owner, but the character of the business remained the same. The law is well settled as to the rights of a government or a governmental agency when engaged in the conduct of a private and proprietary occupation or business. They are not denied the right of engaging in such a business, but when they do so they are governed by the same rules that govern a private individual or corporation.

As said by Chief Justice Marshall in The United States Bank vs. Planters Bank of Georgia, 9 Wheat. 904:

"It is, we think, a sound principle that, when a government becomes a partner in any trading company it divests itself, so far as concerns the transactions of that company, of its sovereign character, and takes that of a private citizen. Instead of communicating to the company its privileges and its prerogatives, it descends to a level with those with whom it associates itself, and takes the character which belongs to its associates, and to the business which is to be transacted * * *. The State of Georgia, by giving to the bank the capacity to sue and be sued, voluntarily strips itself of its sovereign character, so far as respects the transactions of the bank, and waives all the privileges of that character. As a member of a corporation, a government never exercises its sovereignty. It acts merely as a corporator, and exercises no other power in the management of the affairs
64 of the corporation than are expressly given by the incorporating act."

And the observation can be made here that it is not necessary for the Government to become a member of a firm or a stockholder in a corporation in order that it carry on and conduct a private commercial business.

The United States Shipping Board Emergency Fleet Corporation was one of the agencies of the Government created by act of Congress to aid in the conduct of the World War. It was incorporated under the general corporation laws of the District of Columbia pursuant to the act of September 7, 1916, for and on behalf of the United States. The question was considered in re Eastern Shore Shipbuilding Corporation, 274 Fed. 893, of whether it was entitled to the governmental priority in bankruptcy cases. The court held that it

was not entitled to such preference, it being organized as a private corporation, and the fact that all of the stock, except five shares held as qualification shares by the directors, were subscribed for and held by the Secretary of the Treasury on behalf of the United States would not give the company any right which might be claimed under the priority sections above cited. It is true that in this case the United States was a stockholder in a corporation engaged in the private venture of transportation upon the high seas, and the court held to the want of priority for this reason. The court quoted with approval the language of Chief Justice Marshall in the case just cited and quoted above. It can not be denied that the same principle would apply if the Government had organized a corporation to take over all of the railroads in the United States. A difference in the means or agency through which a private business is transacted by the Government would not change the rule. The character of the business would remain the same.

And again, in Salas vs. United States, 234 Fed. 842, the question before the court was whether a conspiracy to defraud the Panama Railroad Company was a conspiracy to defraud the United States. It was held that it was not, notwithstanding the fact that the United States owned the whole capital stock of the railroad company and was solely interested in its profits or losses. The court said in this case:

"When the United States enters into a commercial business, it abandons its sovereign capacity and is to be treated like any other corporation."

65 Attention might also be called to various quotations already made in this memorandum from Federal decisions which comment upon the relative priority of the United States and other creditors in insolvency and bankrupt cases. Particular reference can be made also to the language of Mr. Justice McReynolds in delivering the unanimous decision of the Supreme Court in the Mellon vs. Michigan Trust Company case, supra, where he said:

"To permit the claimed preference, we think, would conflict with the spirit and broad purpose of the statute. These become plain enough upon consideration of the just ends which Congress had in view, together with the recent policy, revealed by the bankruptcy act, in respect of priorities."

Federal control acts are self-contained with respect to priority

The point urged can be next considered that the Federal control act with its supplemental legislation in itself provided for the manner in which debts to the United States arising out of the control and operation of carriers and ipso facto superseded any priorities existing under section 3466, U. S. Rev. Stat. The operation of common carriers by the Government under authority of the Federal control acts resulted in the United States engaging in an industrial and commercial venture, private in its character and nature. Public ownership of these facilities is not a part of our governmental policy, and

the original Federal control act expressly disclaimed any bearing in the legislation upon the subject of ownership and control. The acts, moreover, were in their character emergency legislation and so stated in them repeatedly. The transportation act of 1920 is a part of the Federal control legislation and supplementary to the original act. The original act of 1918, as well as the act of 1920, as amended, contained manifold and elaborate provisions for the liquidation of debts due the United States through the purchase or acquirement by the Government of notes, obligations, and other securities of the carriers. Provision was made for the sale of these securities to the public. Unmistakably in view of all existing conditions it was the intention of Congress that expenditures by the Government in connection with the operation of railroads in excess of the securities sold the public should be considered a part of the war disbursements and were obligations to be assumed by the Government. The legislation
66 bears all the imprints of the intention on the part of the Congress that the Government should operate the common carriers of the country as a private owner or operator. Aside from the many inferential provisions, in at least two instances express language is to be found which carries out this conclusion. In section 7 of the original act, which provides for securing funds necessary for maturing obligations or other legal and proper expenditures or for reorganizing railroads in receivership and the issuance by the carrier in liquidation of such advances of bonds, notes, equipment, trust certificates, stock, and other forms of securities either secured or unsecured by mortgage, it was stated that—

"any securities so purchased shall be held by the Secretary of the Treasury, who shall under the direction of the President represent the United States in all matters in connection therewith in the same manner as a private holder thereof."

Section 10 of the original act in connection with litigation and the enforcement of substantive rights stated that—

"In any action of law or suit in equity against the carrier no defense shall be made thereto upon the ground that the carrier is an instrumentality or agency of the Federal Government."

This section has been construed both in the Circuit Court of Appeals and by the Supreme Court of the United States in the case of Mellon Director General vs. Michigan Trust Company, 271 U. S. 234, and in both cases the decision was contrary to the contention of priority urged by the United States. Reference has already been made to these cases.

The national bankruptcy act with its various amendments, which provides for the priorities of debts due the United States, limits these to taxes and by virtue of such limitation eliminates therefore the United States as a prior creditor for other debts due to it from the bankrupt. These acts have been construed repeatedly by the Federal courts as superseding all priorities given in section 3466, U. S. Rev. Stat. The old national banking legislation also contained pro-

visions for the security and payment of debts due the United States from insolvent banks, and likewise repeated decisions of the Federal courts have held that these provisions also superseded section 3466, U. S. Rev. Stat., and limit the priorities accorded the United States to those given in the banking laws. In connection with these
67 decisions, as well as those passing upon the question of priorities in connection with the Federal control acts, the courts have at times made observations upon the status of the United States as a creditor and the attitude that should be taken by the courts when passing upon the relative priorities of the United States as compared with other creditors. Some of these comments may be quoted here.

In Davis, Director General v. Pullen, 277 Fed. 650, a Federal-control case, the court, although holding a priority in favor of the United States, said:

"That the enterprise in which the Government, under its war powers, engaged in taking over and operating the railroads was not an enterprise within the contemplation of Congress when the priority statute was enacted * * *. This argument has weight. There is a certain obvious injustice in giving the United States when engaged in an industrial and commercial venture, even although under war powers, superior rights over other creditors bearing like relations to insolvents."

This comment was quoted with approval in Mellon, Director General v. Michigan Trust Company, 271 U. S. 512, where the court, after quoting the language above from Davis v. Pullen, said:

"And we think that the indicated purpose of Congress will be best carried out by construing the relevant statutes, so far as may be, with the general intent to preserve the substantive rights of all parties concerned as they would have existed but for Federal control."

In Davis, Federal Agent, v. Pringle, 1 Fed. (2d) 860, the court held that by the act of 1898 the law-making power of the United States limited its priorities in bankruptcy to a claim for taxes and said in commenting upon that ruling:

"We hold that in bankruptcy debts due to the United States other than for taxes have no priority over general creditors. No sound principle of public policy can be invoked in support of preference to the Federal Government and to the States over citizens in the collection of ordinary debts. On the contrary, the contractual operations of the Federal Government and of the States have become so extensive and so involved with the business of private citizens that priority to the Federal Government and to the States, except
68 for taxes, would operate as an oppressive hardship on other creditors of bankrupts."

National Bank v. United States, 107 U. S. 445.

This case held that under section 3466 U. S. Rev. Stat. the United States having demands against an insolvent national bank is not entitled to priority of payment out of its assets over other creditors. The syllabus being that—

"the act authorizing the formation of national banks was a separate code by itself and neither limited nor enlarged by other statutory provisions with respect to the settlement of demands against insolvents or their estates, and giving no preference to any claim, except for moneys to reimburse the United States for advances in redeeming the notes."

Could it not fairly be said that the Federal control acts with respect to the payment and adjustment of accounts and transactions between the carriers and the Government and which so carefully provided means for the reimbursement of the United States and the giving of collateral securities for the protection of the United States was intended to supersede as to priority of payment section 3466. Bearing upon this thought the reasoning of the court in this case and in holding that the banking act superseded section 3466 as to the right of priority, it is interesting to read the opinion and argument of the court. The court said:

"In addition to these conflicting provisions in the banking law, necessarily superseding those of the law of 1797, as to the priority of the United States in the payment of their demands out of the estates of insolvents, there is the significant declaration of the banking law that, for any deficiency in the proceeds of the bonds deposited as security for the circulating notes of the bank, the United States shall have a paramount lien upon all its assets, which shall be made good in preference to all other claims, except for costs and expenses in administering the same. This declaration was unnecessary and quite superfluous if, for such deficiency, the United States already possessed, under the act of 1797, the right to be paid out of the assets of the bank in preference to the claims of other creditors. The declaration considered in connection with the ratable distribution of the assets prescribed after such deficiency is provided for is equivalent to a declaration that no other priority in the distribution of the proceeds of the assets is to be claimed."

69 United States v. State of Oklahoma, 261 U. S. 253.

The question of the relative priority of creditors including the United States, under section 3466 was involved in this case in connection with the alleged insolvency of the State Bank of Guthrie, Oklahoma. Mr. Justice Butler, writing the opinion, said as to the effect and scope of section 3466:

"It has been considered in a number of cases in this court. The claim of the United States to the asserted priority rests exclusively upon the statute. No lien is created by it. It does not overreach or supersede any bona fide transfer of property in the ordinary course of business. It establishes priority which is limited to the particular state of things specified. The meaning of the word 'insolvent' use in the act and of the insolvency therein referred to, is limited by the language to cases where a debtor not having sufficient property to pay all his debts shall make a voluntary assignment."

And it was then held that the State Bank of Guthrie was not insolvent or had not made a voluntary assignment within the meaning of the statute.

In re Stork Contractors' Export Corporation, petition of Director General of Railroads, 285 Fed. 438, Comp. Stat. 6372, p. 438:

"At the time of its bankruptcy a corporation had certain lumber in course of transportation by the Railroad Administration, which unloaded the lumber on its own ground and several months later sold it. Held, that, while demurrage until unloading, and the cost of unloading, were proper claims against the estate, a charge for storage as demurrage and at the demurrage rate after bankruptcy was not allowable as a prior or preferential claim or debt due the United States, under Rev. Stat. 3466 (Comp. St. 6372); also that the director general was chargeable with the fair value of the lumber at the time of bankruptcy."

The court said in sustaining the decision as stated above:

"I can not believe that the act of Congress contemplated to make it possible for the director general in such cases as this to absorb a large portion of the estate of the bankrupt, the assets actually belonging to the creditors of the bankrupt after the payment of just liens, priorities, and costs. I do not believe that the law authorizes or that the courts can sanction such a doctrine."

In re C. J. Rowe & Bros., 18 Fed. (2d) 658, the case involved
70 bankruptcy proceedings and priority of the United States for taxes due. On the particular question of whether a claim for rent for which it was alleged a lien had been acquired through distraint proceedings the court said:

"The specific lien acquired by a landlord by means of a distraint is not such a lien as is 'obtained through legal proceedings' as contemplated by section 67–f of the bankruptcy act, and is not divested by the bankruptcy of the tenant within four months. (Citing cases.) On the other hand, section 3466, Rev. Stat., created no lien, and the priority by it does not attach while the debtor continues the owner and in possession of the property. Citing U. S. v. Oklahoma, 261 U. S. 253; Beaston v. Farmers' Bank, 12 Peters 102. In section 64 the court said that it was intended to create priority of payment in favor of certain classes, who, in the absence of statute, would be general creditors of the bankrupt. It did not contemplate an advantage to the classes given priority as against holders of valid specific liens such as existed at the time the petition was filed."

With these decisions in mind and those construing the Federal control legislation, the general conditions at the time the private character of the business engaged in and the legislation itself, with its elaborate provisions for the issuing of securities and their sale to the public, it certainly will not be a forced or strained construction of that legislation to hold that it was the intent of Congress that in cases like the present one the status of the United States as a creditor should be that on a parity with other general unsecured creditors of the insolvent railroad.

In equity cases Government stands on parity with other litigants

The present receivership is a proceeding in equity, and the rule is that in an equity case the Government is subjected to the same rules respecting the burden of proof, the quantity and character of evidence, and the presumptions of law and fact that attend the prosecution of a like action by an individual. When the Government comes into a court of equity asserting a property right, it occupies the position of any and every other suitor. Its rights are precisely the same, no greater or less. This rule is especially pertinent in respect to that phase of the Government claims which involve the determination of rights not dependent upon statutory provisions but upon general equitable principles. The rule above stated
71 is well supported by many reported decisions, a few of which will be referred to. Quoting first from the Eight Circuit Court of Appeals in the case of Hemmer v. United States, 204 Fed. 898, Walter H. Sanborn, presiding judge, said:

"This is a suit in equity. In such a suit the claims of the Government appeal to the conscience of the chancellor with no greater or less force than those of a private individual under similar circumstances."

This decision was affirmed in 241 U. S. 379.

Robert Y. Brent vs. Bank of Washington, 10 Peters 594.

In the course of the decision in this case Mr. Justice Baldwin said on page 614:

"Thus compelled to come into equity for a remedy to enforce a legal right, the United States must come as other suitors, seeking in the administration of the law of equity, relief, to give which courts of law are wholly incompetent on account of the legal bar interposed by the bank. This court, in The United States vs. Mitchel, 9 Peters, 743, have recognized the principle in the common law that though the law gives the King a better or more convenient remedy, he has no better right in court than the subject through whom the property claimed comes to his hands. (Citing cases.) This principle is also carried into all the statutes by which the appropriate courts are authorized to decide and under which they do decide on the rights of a subject in a controversy with the King, according to equity and good conscience between subject and subject."

United States vs. Barker, 12 Wheaton 559, 6 L. Ed. 728:

"The court were of opinion that there was negligence either at Washington or New York as to giving such notice, and that the notice actually given was too late to fix him with the responsibility. The letter from the Treasury Department giving the notice was either not sent in due course of mail to New York or there was negligence at New York in not giving notice there as early as it should have been given after the letter arrived at that city. Whether, therefore, the judge erred or not as to the first part of his charge, in respect to the transmission of the bills from England in a reason-

able time, there was no doubt that the United States had no right to recover on account of the neglect in giving due notice after the return of the bills."

United States vs. Smith, 4 Otto 214, 94 U. S. 115:

"In Clarke's case, 6 Wall. 546 (73 U. S. XVIII, 917), it was
72 decided that the United States were liable for damages resulting from an improper interference with the work of a contractor; and in Smoot's case, 15 Wall. 47 (82 U. S. XXI, 110), that the principles which govern inquiries as to the conduct of individuals, in respect to their contracts, are equally applicable where the United States are a party. The same rules were applied in the case of The Mfg. Co., 17 Wall. 592 (84 U. S. XXI., 715). Here the work was stopped by order of the United States. Smith asked to be released from his contract unless he could go on. This was refused until the expiration of sixty days, when he was allowed to resume. As between individuals, certainly, this would be considered an improper interference, and damages would be awarded to the extent of the loss which was the necessary consequence of the suspension. The United States must answer according to the same rule. In this respect we can not consider this case different in principle from that of Clark (supra)."

See also Mitchel vs. United States, 9 Peters, 711, and

United States vs. Stinson, 197 U. S. 200, where the court held that in an equity case the Government is subjected to the same rules respecting the burden of proof, the quantity and character of evidence, the presumption of law and fact that attend the prosecution of a like action by an individual.

United States vs. Ingate, 48 Fed. 251:

"It is well settled that, 'when the United States voluntarily appear in a court of justice, they, at the same time, voluntarily submit to the law, and place themselves upon an equality with other litigants.' U. S. vs. Beebee, 17 Fed. Rep. 40; U. S. vs. Barker, 12 Wheat. 559; Mitchel vs. U. S. 9 Pet. 743; Brent vs. U. S. 10 Pet. 615. 'The principles which govern inquiries as to the conduct of individuals in respect to their contracts are equally applicable where the United States are a party.' U. S. vs. Smith, 94 U. S. 217. In Brent vs. Bank, 10 Pet. 615, the court declares that there is no reason why the United States should be exempted from a fundamental rule of equity subject to which their courts administer their remedy. In 18 Fed. Rep. 278, in the case of U. S. vs. Coal, etc., Co., the court says:

"'It is true, as a general proposition, that when the Government becomes a party to a suit in its own courts it stands upon the same footing with individuals, and must submit to the law as it is
administered between man and man. But this general rule
73 has its limitations, in that neither the defense of the statute of limitations nor that of laches can be pleaded against the United States.'

"These authorities, it seems to me, answer the first question we have been considering in the affirmative."

United States vs. Detroit Timber & Lumber Co., 131 Fed. 668:

"Finally, this is a suit in equity. The equitable claims of the United States appeal to the conscience of a chancellor with the same, but with no greater or less, force than would those of an individual in like circumstances."

United States vs. Clark, 138 Fed. 294:

"As a matter of course, when the Government comes as a suitor into a court of equity, its claims appeal to the chancellor with no greater force than do those of an individual under like circumstances."

Mountain Copper Co. vs. United States, 142 Fed. 625:

"It is the well-established law that, when the Government comes into a court asserting a property right, it occupies the position of any and every other suitor. Its rights are precisely the same; no greater, no less. United States vs. Clark (C. C. A.), 138 Fed. 294; United States vs. Detroit Timber & Lumber Co., 131 Fed. 668, 67 C. C. A. 1; United States vs. Flint, 4 Sawy. 42, Fed. Case No. 15,121; Foster's Federal Practice, sec. 63; United States vs. Barker, 12 Wheat. 559, 6 L. Ed. 728; Mitchel vs. United States, 9 Pet. 743, 9 L. Ed. 283; Brent vs. Bank of Washington, 10 Pet. 615, 9 L. Ed. 547; United States vs. Smith, 94 U. S. 217, 24 L. Ed. 115; Am. & Eng. Enc. of Law (2d Ed.), vol. 4, p. 271."

Diversion funds, if any, an equitable charge only in favor of current supply operating creditors

In an insolvent railroad receivership in disposing of claims two questions ordinarily arise, first, are the claims entitled to a preferential status, and second, if so, is there a fund actual or potential from which they can be paid? The two questions are distinct. They must both be answered affirmatively before such claims can properly be paid. In the present instance there are several sources of payment open to creditors secured and unsecured of the Minneapolis & St. Louis. The corpus of the property as encumbered by established mortgage liens with accrued interest approximating $56,000,000. Cash on hand at the time of the receivership, a negligible amount; net operating income of the receiver, also at the
74 present writing as uncertain and negligible amount; the unmortgaged assets of the company as listed in schedule ten of the master's report in the foreclosure cases and the fund established through the doctrine of diversions as stated in my findings of fact. As against these resources of the company receiver's certificates as a prior obligation over all other debts and liabilities are outstanding in the amount of $1,950,000. The corpus of the property is encumbered by mortgage indebtedness to the extent as stated above. It is improbable that the property of the Minneapolis & St. Louis will sell at foreclosure sale for more than the amount of the mortgaged indebtedness with accrued interest. The only probable source

of payment, therefore, left would be the unmortgaged assets and the so-called diversion fund. The question naturally then arises as to the relative priorities of the United States with respect to such diversions as compared with the priority of the current operating supply creditors. These the master already has found are entitled to a special preference or priority to these funds, and in this respect he has also held that the Government in any event is not entitled to participate or share in the diverted funds which may ultimately be found available for the payment of the preferred supply claimants. In support of this conclusion a brief review of the decisions upon the doctrine of diversions and the character of a fund so designated is necessary.

The subject of diversions with principles of law applicable was considered at length by the master in connection with the claims of the Albia Coal Company and others. A memorandum of authorities will be found on pp. 3115 to 3198, both inclusive, of the printed record and to which reference is made in order to avoid a useless repetition. Summarizing briefly the doctrine of diversions as stated and sustained without exception by all Federal decisions in which the question arose, the following statement of principles may be made:

That a railroad is a peculiar kind of property, in that it owes to the public a duty as a common carrier not devolving upon other private corporations. That there exists a necessity for its continued operation both from its character as a public or common carrier and also as affording to the mortgagees the best security for the debt for which its property has been pledged; that current and necessary supplies for such continued operations are secured upon the assumption and with the expectation of those furnishing
75 such supplies and labor that they will be paid from the current or gross earnings of the road; that there is an implied contract on the part of every railroad mortgagee in accepting his security that the current debts for current supplies and labor made in the ordinary course of business shall be paid from the current receipts before he has any claim upon the income; that if the interest is paid on the mortgage debt or disbursements made which enhance the value of securities, these payments constitute a diversion of funds to that extent from the rightful purpose for which they should have been used; and that if the mortgagee chooses upon his own volition and under no compulsion to ask for and secure an equity receivership the court may require him to restore either from receivership income or if necessary from the proceeds of the sale of the pledged property the moneys so diverted in order that the persons who are rightfully and equitably entitled to a payment for their supplies, materials, and the like may be paid.

A better definition of the class of debts for whose benefit the doctrine of diversions was established can not be given than by quoting the language of Judge Walter H. Sanborn, then judge of the Circuit

Court of Appeals for the Eighth Circuit, in the case of Illinois Trust & Savings Bank vs. Doud, 105 Fed. 123, where he said:

"The class of claims which may be awarded a preference in payment over the prior mortgage debt in equity is limited to claims for current expenses incurred in the ordinary course of the operation of the mortgaged property within a limited time before the appointment of a receiver. It does not include claims for money loaned or for material or labor furnished to make necessary beneficial and permanent additions or improvements to the mortgaged property. The broad language of the dicta in Fosdick vs. Schall, that 'necessary operating and managing expenses, proper equipment, and useful improvements' are to be deducted from the current income before the net income out of which the mortgage debt is to be paid arises, has been disapproved and modified, and the class of claims entitled to equitable preference has been limited, by the later decisions of the Supreme Court in (citing cases) to claims incurred for the current expenses of the operation of the mortgaged property in the ordinary course of the business of the mortgagor."

And again, in Chicago & Alton Railroad Company vs. U. S. Mexican Trust Company, 225 Fed. 940, where Judge Sanborn
76 said in defining the class of claims entitled to the benefit of the doctrine:

"It is true and a mortgagee of the property and income of an operating railroad company impliedly agrees that the current expenses of the ordinary operation of the railroad for wages, supplies, materials, and such necessities of operation for six months before the impounding of the income for its benefit may be first paid out of the gross income of operation, before that net income arises which the mortgagee's lien holds fast, and that a court of equity administering railroad property in a foreclosure suit may prefer unpaid claims for such current expenses incurred within six months before the impounding of the income to the claims of bondholders secured by a prior mortgage in its distribution of the surplus income of the property, and that if income has been diverted from the payment of such current expenses, leaving some of them unpaid, to the payment of other debts of the mortgagor not in this preferential class. The court may restore from the proceeds of the corpus of the property the amount thus diverted and apply it to the payment of such current expenses. But if there had been no diversion there can be no restoration, and the amount of the restoration can not exceed the amount of the diversion."

In Moore vs. Donahoo, 217 Fed. 177, Judge Dietrich of the United States Circuit Court of Appeals for the Ninth Circuit, said:

"So with the unsecured claimant: Such equity as he may have flows from the fact that, in the ordinary course of business he has performed labor or furnished necessary supplies to the railroad company with the reasonable expectation of being paid therefor from

certain funds. His power to enforce his rights should not be made contingent upon the possibility that the secured creditor may apply to a court for the appointment of a receiver or for other equitable relief, a circumstance wholly fortuitous, or at least one over which he exercises no control.

"The real basis upon which the preference rests is thought to be the implied understanding on the part of all parties that such debts are to be paid out of the current income before the mortgagee has any claim thereto. Reference to a few of the decisions of the Supreme Court will be sufficient to make this clear."

Texas Company vs. International & Great Northern Railway Company, 237 Fed. 921:

77 This was a decision of the Circuit Court of Appeals for the Fifth Circuit and the court, after citing and quoting from Fosdick vs. Schall, Burnham vs. Bowen, and Carnegie Steel Company cases, infra, referred to the right of the current supply operating creditors for payment and said that they would be receiving then in part, at least, that which in equity belongs to the whole or a part of the general creditors. It was inequitable—

"that the mortgagee should profit in this respect at the expense of supply and labor claimants through the placing of the mortgaged property in the hands of a receiver."

The doctrine of diversions was first stated at length in the case of Fosdick vs. Schall, 99 U. S. 235, where the court said that the business of all railroads was done to a greater or less extent on credit. That this credit was longer or shorter as the necessities of the case required; and that when companies become pecuniarily embarrassed it frequently happened that debts for labor and supplies were permitted to accumulate in order that bonded interest might be paid and a disastrous foreclosure postponed, if not altogether avoided. In this way the court said:

"The daily and monthly earnings, which ordinarily should go to pay the daily and monthly expenses, are kept from those to whom in equity they belong, and used to pay the mortgage debts."

And further:

"If for the convenience of the moment something is taken from what may not improperly be called the current debt fund, and put into that which belongs to the mortgage creditors, it certainly is not inequitable for the court, when asked by the mortgagees to take possession of the future income and hold it for their benefit, to require as a condition of such an order that what is due from the earnings to the current debt shall be paid by the court from the future current receipts before anything derived from that source goes to the mortgagees. In this way the court will only do what, if a receiver should not be appointed, the company ought itself to do."

The opinion in this case was written by Mr. Chief Justice Waite, and the court then goes on to say that if current operating income has

been used for the payment of bonded interest or the purchase of additional equipment or the making of lasting and valuable
78 improvements, which ought in equity to have been employed to keep down debts for labor, supplies, and the like, it is within the power of the court to use the income of the receivership for the discharge of these obligations and that this is not because the creditors to whom such debts are due have a lien upon the mortgaged property or the income, but because, in a sense, the officers of the company are trustees of the earnings for the benefit of the different classes of creditors and the stockholders, and if they give to one class of creditors that which properly belongs to another the court may, upon an adjustment of the accounts, so use the income which comes into its own hands as, if practicable, to restore the parties to their original equitable rights. And the court further said:

"While ordinarily this power is confined to the appropriation of the income of the receivership and the proceeds of moneyed assets that have been taken from the company, cases may arise where equity will require the use of the proceeds of the sale of the mortgaged property in the same way."

In Burnham et al. vs. Bowen, 111 U. S. 776, the court said:

"The business of every railroad company is necessarily done more or less on credit of all parties understanding that current expenses are to be paid out of current earnings."

And further the court said:

"The business of every railroad company is necessarily done more or less on credit of all parties understanding that current expenses are to be paid out of current earnings. Consequently it almost always happens that the current income is encumbered to a greater or less extent with current debts made in the prosecution of the business out of which the income is derived * * *."

And the court expressly held in that case that diversions of income, "created a charge on the property for whose benefit it had been made,"

and also that,

"under these circumstances we think the debt was a charge in equity on the continuing income as well as that which came into the hands of the court after the receiver was appointed as that before."

79 Reference may be made to only one more case in the United States Supreme Court, that of Southern Railway Company vs. Carnegie Steel Company, 176 U. S. 257, in which the Supreme Court discussed at length the rights of claimants, presenting in a railroad receivership their demands for payment of supplies furnished by them and necessary to enable the railroads to continue its operations. The doctrine of diversions with the equitable rights of current operating supply creditors, as stated in Fosdick vs. Schall, supra, and

Burnham vs. Bowen, supra, was reiterated and followed. In the Carnegie Steel Company case the court expressly said:

"That when current earnings are used for the benefit of mortgage creditors before current expenses are paid, the mortgage security is chargeable in equity with the restoration of any fund thus improperly diverted from their primary use."

In Virginia & Alabama Coal Company vs. Central Railroad & Banking Company, 170 U. S. 355, Mr. Justice White, afterwards Chief Justice, uses in connection with the right of current supply claimants the following language:

"Nor is the equity of a current supply claimant, etc."

The inevitable deduction from all the authorities, a few only of which are cited above, is that the claim of the current supply operating creditors rests in part upon the public character of the railroads; that their continued operation is a matter of public concern; that they can not do business on a cash basis; that temporary credit is essential to the continued operation of the roads; that consequently current supplies, material, and labor must be secured through credit; and that there must be an express or implied agreement that the debt should be paid from the current earnings. The agreement necessarily affects all doing business with a railroad company, and this conclusion logically follows because the current supply operating creditors in all the decisions have been held in equity to displace the mortgage debts and inferentially all others, for it is established beyond question that the mortgage debts are a first lien upon the properties and income pledged. The Supreme Court of the United States, as well as other Federal courts, have held repeatedly that the rights of that class of preferred creditors described above is an equitable charge upon the net income and also upon the corpus to the extent of diversions. The rights of preferred creditors, it has been
80 repeatedly held, extend only to the diversions as established, if any. On this last proposition it is only to refer to Gregg vs. Metropolitan Trust Company, 197 U. S. 183, where the court expressly held that if there were no diversions there could be no restorations by the mortgage creditors. The diverted funds, if any, as ultimately established in this case are those created solely through an application of the doctrine of diversions, which was devised by the courts especially and exclusively for the benefit of current operating supply creditors. It is not asserted, nor can it be claimed, that the debts due the United States are claims of such a character.

The case in which the Government claims are filed was brought originally by creditors of this class upon a bill asking for the impounding of the income through a receivership, the restoration of diversions and for a lien upon the corpus to the extent thereof, and is in foreclosure of the lien so sought to be established. The basis of this suit is the foreclosure of such a lien. Moreover the Government stands in the position of a secured creditor. A deposit as collateral of refunding and extension class "A" bonds was made to secure specified items of its claim, as well as all other indebtedness to the

Government on the part of the Minneapolis & St. Louis Railroad Company.

The case of Brent vs. Bank of Washington, 10 Pet. 596, establishes unanswerably the provision that the priorities of the United States do not displace either a bona fide transfer of properties made by the debtor before insolvency or bankruptcy, a specific vested lien, or an equitable lien or special equity of a claimant against property in the hands of an insolvent at the time of divesture within the meaning of section 3466, U. S. Rev. Stat. It will be remembered that in that case the debts due the bank included not only debts due at the time of the insolvency, but also notes which were then not yet due.

Claim No. 1827 is allowed as a special preferential account entitled to immediate payment out of any funds in the hands of the receiver available for said purpose. This claim is based upon a fine imposed by the United States District Court for the Eastern Division of the Northern District of Illinois on account of the violation of the so-called quarantine act by the Minneapolis & St. Louis Railroad Company. The authorities are uniform in holding that a fine thus im-
imposed for the violation of a statute is in the nature of a pun-
81 ishment, not a debt. Under these conditions it seems clear that the claim should be accorded the preference above allowed.

The point made by counsel for the Government that the earliest cases failing to accord the United States a priority under the statute as against liens were based on the theory that a mortgage was an actual conveyance of the property cannot be sustained. Take the Conard case for illustration. The opinion in this case refers to a decision of that court in Thelusson vs. Smith, 2 Wheat. 396, where the nature of a mortgage was discussed, and then goes on to say that a mortgage is a transfer of the property itself as security for the debt. It is held by the mortgagee as a trust estate and according to the intention of the parties as a qualified estate and security. When the debt is discharged there is a resulting trust for the mortgagor. The term "lien" is used, so the court states, only by way of contrast to an estate absolute and indefeasible. A mortgage, it is held, does not grant such an estate, and in this respect this decision is entirely in harmony with modern authorities.

The master has found the principal only of the claims allowed for the reason that in the original order dated August 20, 1923, it was provided that claims should be proved on the basis of allowance of interest to July 26, 1923, the date of the appointment of the receiver, without prejudice to the right, if any, of the creditors to demand and receive interest accruing thereafter, upon accounts allowed. When passing upon claims of the Chicago Pneumatic Tool Company and others certain of the claimants failed to prove interest, although asking for such an allowance. The master then held that the amount of the interest claimed was as much a matter of proof by the claimant as that of the principal of the claim itself and declined in that instance, as well as others, to allow interest. On exceptions to this ruling Judge Wilbur F. Booth, judge of the Circuit Court of Ap-

peals for this circuit, acting in this case by assignment, on June 3, 1927, overruled the exceptions and said in connection with that ruling:

"The special master has adopted the customary and practical rule of allowing interest only where the claimant has demanded it and has properly proven the amount. In the case of claim No. 854 of the Union Metal Products Company, while interest was demanded there was no proper proof of the amount. Hence no interest was allowed."

82 The record in this case fails to disclose the proof of any specific amount of interest due upon any of the claimes filed by the United States or any of the items thereof.

HOWARD S. ABBOTT,
Special Master.

[File indorsement omitted.]

In United States District Court

Exceptions of United States to report of special master

Filed Aug. 31, 1928

Now comes the United States of America, one of the claimants in the above-entitled cause, and by its counsel states and makes its exceptions to the findings contained in the report of H. S. Abbott, special master, hereinbefore filed on August 13, 1928, as follows:

1. The master finds that the United States of America is not entitled to participate in the fund ultimately established, if any, through the doctrine of diversions.

The United States excepts to this finding on the ground that it is contrary to the specific provision of section 3466, Revised Statutes.

2. The master finds that as to claim No. 2700, items 1, 3, and 4 thereof, and claim No. 4186 the United States is entitled to recover only as a general creditor and "without any preference or priority in payment" (except as to collateral security).

The United States excepts to this finding in that it is erroneous in law, being contrary to the specific provision of section 3466, Revised Statutes, which declares that whenever any person indebted to the United States is insolvent the debts due the United States shall be first satisfied.

3. Exception is taken to the master's finding that counsel for the United States stated at the hearing of its claims that the case of Mellon vs. Michigan Trust Company, 271 U. S. 236, would apply to the two items of claim No. 2700 in the amount of $625,000 each on the ground that such finding erroneously indicates that the United States has relinquished and abandoned its claim to priority with respect to said items, which it has not done nor intended so to do. The discussion to which reference is made in this finding related merely to the possible effect of the decision in said case.

83 4. The master finds that the United States is not entitled to interest on the principal sums proved, for the reason stated that no profit of the actual amount of interest due at the date of the hearing has been submitted.

The United States excepts to this finding on the ground that the right of the Government to interest has been proved, although the exact amount of unpaid interest was not calculated and submitted in evidence. Proofs of claims filed December 21, 1923, and April 28, 1924, contain demands for interest along with the claims for the principal of the respective items. Proof of the Government's claim and right to interest is contained also in the documents already in evidence; that is, the promissory notes evidencing the obligations introduced by the Government on hearing.

Wherefore, the United States prays:

1. That the aforesaid exceptions may be allowed;

2. That the findings of the special master to which the above exceptions are made may be disapproved and reversed;

3. That in the event the court adopts the finding of the special master to which the fourth exception above is made, then that the court grant an opportunity to the United States to submit further proof and calculations of the exact amount of interest due upon said principal sums;

4. That the United States may have such other and further relief as the equities of the case may require and to the court may seem proper.

(Signed) WILLIAM J. DONOVAN,
The Assistant to the Attorney General.
(Signed) ELMER B. COLLINS,
Special Assistant to the Attorney General.

AUGUST 29, 1928.

[File indorsement omitted.]

84 In United States District Court

Exceptions of H. H. Sheriff to report of special master.

Filed Sept. 1, 1928

H. H. Sheriff excepts to that part of report of special master filed August 13, 1928, in respect to the claims of the United States wherein the master finds the defendant railroad company insolvent within the meaning of Federal statutes relating to priority of the United States.

Dated August 31, 1928.

FOWLER, CARLSON, FURBER & JOHNSON,
By RALPH H. COMAFORD,
815–825 New York Life Building, Minneapolis, Minnesota,
Attorneys for H. H. Sheriff.

In United States District Court

Exception of H. H. Sheriff to report of special master

Filed Sept. 1, 1928

H. H. Sheriff excepts to that part of the report of the special master filed August 13, 1928, in respect to claim No. 1827 of the United States, wherein the master finds that the United States is entitled to recover from the Minneapolis & St. Louis Railroad Company and its receiver the sum of one hundred dollars ($100.00) as a special preference claim.

Dated August 31, 1928.

FOWLER, CARLSON, FURBER & JOHNSON,
By RALPH H. COMAFORD,
815–825 New York Life Building, Minneapolis, Minnesota,
Attorneys for H. H. Sheriff.

[File indorsements omitted.]

85 In United States District Court

In equity, consolidated cause No. 299 with 290

GUARANTY TRUST COMPANY OF NEW YORK, AS TRUSTEE, ET AL.,
complainants

vs.

THE MINNEAPOLIS & ST. LOUIS RAILROAD COMPANY ET AL.,
defendants

Order and decree approving report of special master

Filed Sept. 6, 1928

CLAIMS OF UNITED STATES

This cause came on for hearing upon exceptions to the report of the special master filed August 13, 1928, upon five claims of the United States involved in this litigation. Exceptions to the report were taken by the United States and by H. H. Sheriff, a creditor of the railroad company. Upon the hearing the exception of H. H. Sheriff to the finding of insolvency by the special master was withdrawn.

The court having heard the arguments of counsel and duly considered the same, together with the special master's report and the memorandum attached thereto, the evidence and exhibits introduced before the special master, and the files and records in the cause, hereby orders that the exceptions to the said report of the special master be, and the same are hereby, each and all, overruled; and the report is hereby approved and confirmed.

It is accordingly further ordered, adjudged, and decreed as follows:

Claim 1827

I. (a) That the claim (master's No. 1827) of the United States against the Minneapolis & St. Louis Railroad Com-' as set forth in the report of the special master is hereby allowed in the principal sum of $100.00.

(b) That the whole of this amount is allowed as a special preference claim, and is ordered to be paid out of the current net operating income of the receiver as a special charge thereon, or from any other funds that may be available for that purpose.

Claim 3268

II. (a) That the claim (master's No. 3268) of the United
86 States against the Minneapolis & St. Louis Railroad Company as set forth in the report of the special master is hereby allowed in the principal sum of $85.35.

(b) That the whole of this amount is allowed as a general claim only, and is ordered to be paid pro rata with other claims of like general status from such funds, if any, in the hands of the court in this cause as may now or hereafter be available for that purpose, without any preference or priority either against the corpus of the mortgaged property or in relation to any other claim or class of claims duly filed in this cause.

Claim 4153

III. That the claim (master's No. 4153) of the United States against the Minneapolis & St. Louis Railroad Company is hereby dismissed, the same having been withdrawn by the United States.

Claim 4186

IV. That the claim (master's No. 4186) of the United States against the Minneapolis & St. Louis Railroad Company as set forth in the report of the special master is hereby adjudged to have no preferential status, this being the only question relative to said claim submitted for determination. All other questions relative to said claim are dependent upon litigation pending in another tribunal, and the present determination as to the status of the claim is without prejudice to the right of the United States to pursue all proper remedies and procedure relative to said other questions.

Claim 2700

V. That the claim (master's No. 2700) of the United States against the Minneapolis & St. Louis Railroad Company as set forth in the

report of the special master is hereby adjudicated and allowed as follows:

1. (a) Item one is allowed in the principal sum of $1,382,000.00, and interest thereon to the date of the receivership in the sum of $26,579.84, making a total of $1,408,579.84.

(b) That the whole of the amount is allowed as a general claim only, and is ordered to be paid pro rata with other claims of like general status from such funds, if any, in the hands of the court in this cause as may now or hereafter be available for that purpose, without any preference or priority either against the corpus of the mortgaged property or in relation to any other claim or class of claims duly filed in this cause.

87 2. Item two in the claimed amount of $386,190.00 (later reduced) is adjudged to be an unmatured claim upon which the United States is not now entitled to any recovery. This determination is without prejudice to the right of the United States to pursue in the future all proper remedies and procedure relative to said claim.

3. (a) Item three is allowed in the principal sum of $625,000.00, and interest thereon to the date of the receivership in the sum of $12,020.55, making a total of $632,020.55.

(b) That the whole of this amount is allowed as a general claim only, and is ordered to be paid pro rata with other claims of like general status from such funds, if any, in the hands of the court in this cause as may now or hereafter be available for that purpose, without any preference or priority either against the corpus of the mortgaged property or in relation to any other claim or class of claims duly filed in this cause.

4. (a) Item four is allowed in the principal sum of $625,000.00, and interest thereon to the date of the receivership in the sum of $12,020.55, making a total of $637,022.55.

(b) That the whole of this amount is allowed as a general claim only, and is ordered to be paid pro rata with other claims of like general status from such funds, if any, in the hands of the court in this cause as may now or hereafter be available for that purpose, without any preference or priority either against the corpus of the mortgaged property or in relation to any other claim or class of claims duly filed in this cause.

5. Item five in the claimed amount of $403,200.00 (later reduced) is made up of a series of unmatured claims upon which the United States is not now entitled to any recovery. This determination is without prejudice to the right of the United States to pursue in the future all proper remedies and procedure relative to said claim.

6. Interest on items one, three, and four of claim 2700 was not allowed by the special master, for the reason that no sufficient proof of interest was made. Upon the present hearing leave was asked by the United States and allowed by the court to offer such proof, and the same was offered and received.

Exceptions are allowed to the United States to the disallowance of any priority in the foregoing order and decree to claim
88 2700, items one, three, and four, and to claim 4186. Exception is also allowed to H. H. Sheriff to the allowance of special preference in the foregoing order to claim 1827.

Dated September 6, 1928.

WILBUR F. BOOTH,
U. S. Circuit Judge, acting by Assignment.

In United States District Court

Memorandum opinion

Filed Sept. 6, 1928

The character and history of the several claims passed upon in the foregoing order and decree, together with the reasons for the allowance or disallowance of the claims or items thereof, are fully set forth in the able and exhaustive report of the special master and memorandum attached thereto. In the conclusions reached therein I fully agree, and I do not deem necessary at this time a further discussion of the questions involved.

BOOTH, *J.*

[File indorsement omitted.]

In United States District Court

Assignment of errors

Filed Sept. 8, 1928

Now comes United States of America, by its attorneys, and, with its petition for appeal hereto prefixed, files its assignment of errors which it avers occurred in the order and decree entered in the above-entitled cause on September 6, 1928, by this court upon claims of the United States of America.

The United States District Court erred:

1. In overruling the exceptions of United States of America to the report of the special master upon claim No. 2700, items one, three, and four thereof, and claim No. 4186.

2. In approving and confirming said report of the special master upon claims of United States of America No. 2700, items one, three, and four thereof, and claim No. 4186.

3. In holding that claim No. 4186 of United States of America has no preferential status.

4. In allowing claim No. 2700, items one, three, and four thereof, as general claims only and in ordering said items to be paid pro rata with other claims of like general status, with-
89 out any preference or priority either against the corpus of the

mortgaged property or in relation to any other claim or class of claims duly filed in this cause.

5. In not adjudging that said claims of United States of America (claim No. 4186, and claim No. 2700, items one, three, and four thereof) are entitled to a preference and priority in payment over and against any and all other claims filed in this cause.

Wherefore United States of America prays that, for the several errors, and each of them, specified above, the decree entered herein on September 6, 1928, be reversed.

WILLIAM J. DONOVAN,
The Assistant to the Attorney General,
ELMER B. COLLINS,
Special Assistant to the Attorney General,
Attorneys for United States of America,
Department of Justice, Washington, D. C.

[File indorsement omitted.]

In United States District Court

Petition for appeal

(Filed Sept. 8, 1928)

Now comes United States of America, one of the claimants in the above-entitled proceedings, and says that on the 6th day of September, 1928, this court entered its order and decree approving the report of the special master upon the claims of the United States and overruling the exceptions filed by the United States of America to said report of the special master.

That in said order and decree certain errors were committed to the prejudice of the United States of America, which errors will more fully appear in detail from the assignment of errors annexed to this petition and filed herewith.

Wherefore United States of America prays that an appeal may be allowed in its behalf, returnable to the United States Circuit Court of Appeals for the Eighth Circuit of the United States, 90-93 for the correction of the errors so complained of, and that a transcript of the record, proceedings, and papers, relating to said claims of United States of America, duly authenticated, may be sent to said Circuit Court of Appeals, and that the order and decree aforesaid may be reversed.

Dated September 8, 1928.

WILLIAM J. DONOVAN,
The Assistant to the Attorney General,
ELMER B. COLLINS,
Special Assistant to the Attorney General,
Attorneys for United States of America,
Department of Justice, Washington, D. C.

[File indorsement omitted.]

In United States District Court

Order allowing appeal

(Filed Sept. 8, 1928)

Upon reading and filing the attached petition for appeal and assignment of errors thereto annexed, it is hereby

Ordered that the appeal of the claimant, United States of America, from the order and decree entered in this court on the 6th day of September, 1928, be, and the same is hereby, allowed as prayed.

Dated September 8, 1928.

WILBUR F. BOOTH,
United States District Judge, acting by assignment.

[File indorsement omitted.]

[Citation in usual form showing service on Cook, Nathan & Lehman et al., filed Sept. 8, 1928, omitted in printing.]

94 In United States District Court

Præcipe for transcript by United States

Filed Sept. 8, 1928

To the Clerk of the above-entitled court:

You will please prepare the transcript of the record in the above-entitled cause to be filed in the office of the clerk of the United States Circuit Court of Appeals for the Eighth Circuit under the appeal heretofore taken by United States of America, as appellant, vs. Guaranty Trust Company et al., as appellees, which appeal was allowed by the District Court of the United States for the District of Minnesota, Fourth Division, and you will please include in said transcript the following papers, orders, records, and proceedings on file in said cause re claims of United States of America:

1. Paragraph 10 of bill of complaint filed July 25, 1923, by Minneapolis Steel & Machinery Company.
2. Answer filed by Minneapolis & St. Louis Railroad Company to said bill of complaint.
3. Report of the special master, filed August 13, 1928, upon claims of the United States of America and memorandum attached to said report.
4. Exceptions filed by United States of America to said report of the special master, also all other exceptions to said report filed by any and all parties hereto.
5. Order and decree of court dated September 6, 1928, approving report of special master on said claims of United States, together with the court's memorandum attached thereto.
6. Process on this appeal.

Said transcript is to be prepared as required by law and the rules the United States Circuit [—] of Appeals for the Eighth Circuit d the rules of practice for the courts of equity of the United ates.

WILLIAM J. DONOVAN,
The Assistant to the Attorney General,
ELMER B. COLLINS,
Special Assistant to the Attorney General,
Attorneys for United States of America,
Department of Justice, Washington, D. C.

Service of a copy of the foregoing præcipe is acknowledged this 8th day of September, 1928.

Cook, Nathan & Lehman, O'Brien, Horn & Stringer, attys., Bache Committee; Cadwalader, Wickersham & Taft, Sanborn, Graves & Stringer, attys., Perkins Committee; Cobb, Hoke, Benson, Grause & Faegre, attys., Mpls. Steel & Mach. Co.; Fowler, Carlson, Furber & Johnson, attys., H. H. Sheriff et al.; J. H. Mulally, atty., Great Northern Ry. Co.; Donald Evans, solicitor, M. & St. L. R. R. Co.; M. M. Joyce, counsel for receiver, M. & St. L. R. R. Co.; Davis, Polk, Wardwell, Gardiner & Reed, Winston, Strawn & Shaw, Davis, Severance & Morgan, attys., Guaranty Trust Co.; Larkin, Rathbone & Perry, F. G. Ingersoll, attys., Central Union Trust Co.; Alexander & Green, Doherty, Rumble, Bunn & Butler, solicitors, Bankers Trust Co.; Geller, Rolston & Blanc, Boyesen, Otis, Brill & Faricy, solicitors, Farmers Loan & Trust Co.; White & Case, Kingman, Cross, Morley & Cant, attys., New York Trust Co. and Bennett Committee; C. W. Bunn, atty. for Northern Pac. Ry. Co.; Washburn, Bailey & Mitchell, by C. R. Fowler, attys., for Duluth Boiler Works et al.

[File indorsement omitted.]

In United States District Court

[Title omitted.]

Notice of appeal

Filed Sept. 11, 1928

To Messrs.—

Davis, Polk, Wardwell, Gardiner & Reed, 44 Wall St., New York, N. Y.; Winston, Strawn & Shaw, First Natl. Bank Bldg., Chicago, Ill.; Davis, Severance & Morgan, Merchants Natl. Bank Bldg., St. Paul, Minn., attorneys for Guaranty Trust Company.

Cobb, Wheelwright, Hoke & Benson, 300 Security Bldg., Minneapolis, Minn., attorneys for Minneapolis Steel & Machinery Co.

Washburn, Bailey & Mitchell, Alworth Bldg., Duluth, Minn., attorneys for Duluth Boiler Works, intervenor, et al.

Donald Evans, Equitable Bldg., Des Moines, Iowa, solicitor for the Mpls. & St. L. R. R. Co.

Fowler, Carlson, Furber & Johnson, 817 N. Y. Life Bldg., Minneapolis, Minn., attorneys for H. H. Sheriff, intervenor, et al.

J. H. Mulally, St. Paul, Minn., attorney for Great Northern Ry. Co.

White & Case, 14 Wall Street, New York, N. Y., Kingman, Cross, Morley & Cant, 1010 Security Bldg., Minneapolis, Minn., attorneys for New York Trust Company and Bennett Committee.

Larkin, Rathbone & Perry, 80 Broadway, New York, N. Y., F. G. Ingersoll, 1401 Merchants Natl. Bank Bldg., St. Paul, Minn., attorneys for Central Union Trust Company.

Alexander & Green, 120 Broadway, New York, N. Y., Doherty, Rumble, Bunn & Butler, 1006 Merchants Natl. Bank Bldg., St. Paul, Minn., solicitors for Bankers Trust Company.

Geller, Rolston & Blanc, 22 Exchange Place, New York, N. Y., Boyesen, Otis, Brill & Faricy, Endicott Bldg., St. Paul, Minn., solicitors for the Farmers Loan and Trust Company.

Charles W. Bunn, St. Paul, Minn., solicitor for Northern Pacific Ry. Company.

Cadwalader, Wickersahm & Taft, 40 Wall St., New York, N. Y., Sanborn, Graves & Ordway, Endicott Bldg., St. Paul, Minn., solicitors for Perkins Committee.

Cook, Nathan & Lehman, Trinity Bldg., New York, N. Y., O'Brien, Horn & Stringer, Pioneer Bldg., St. Paul, Minn., solicitors for Bache Committee.

M. M. Joyce, counsel for receiver, Minneapolis & St. Louis Railroad Co., 514 Metropolitan Life Bldg., Minneapolis, Minn.

98 W. H. Bremner, receiver of the M. & St. L. R. R. Co. Transportation Bldg., Minneapolis, Minn.

You will please take notice that the United States of America, claimant in the above-entitled cause, appeals to the United States Circuit Court of Appeals for the Eighth Circuit from the decree of the District Court for the District of Minnesota, Fourth Division, entered on September 6, 1928, in the above-entitled cause.

The reasons for said appeal are fully set forth in the assignment of errors attached hereto.

WILLIAM J. DONOVAN,
The Assistant to the Attorney General
ELMER B. COLLINS,
Special Assistant to the Attorney General
Attorneys for United States of America,
Department of Justice, Washington, D. C.

SEPTEMBER 8, 1928.

STATE OF MINNESOTA,
County of Hennepin, ss:

Elmer B. Collins, being first duly sworn, on oath deposes and says that on, to wit, September 8, 1928, he delivered a true copy of the

above notice of appeal to each of the above named solicitors and attorneys for appellees, with the exception of Washburn, Bailey & Mitchell and Fowler, Carlson, Furber & Johnson.

ELMER B. COLLINS.

Subscribed and sworn to before me this 8 day of September, 1928.

[NOTARIAL SEAL.] M. H. McDERMOTT,
Notary Public, Hennepin County, Minn.

My commission expires Mar. 25th, 1932.

STATE OF MINNESOTA,
County of Hennepin, ss:

A. L. Beeler, being first duly sworn, upon oath deposes and says that on September 11, 1928, he served a true and correct copy
99 of the above notice of appeal on Washburn, Bailey & Mitchell and Fowler, Carlson, Furber & Johnson, by delivering to Mr. C. R. Fowler personally true and correct copies of the hereto attached notice of appeal.

A. L. BEELER.

Subscribed and sworn to before me this 11th day of September, 1928.

[NOTARIAL SEAL.] M. H. McDERMOTT,
Notary Public, Hennepin County, Minn.

My commission expires Mar. 25th, 1932.

(Copy of assignment of errors attached to original.)
[File indorsement omitted.]

In the United States District Court

Præcipe for additional transcript by H. H. Sheriff

Filed Sept. 20, 1928

To the Clerk of the above-entitled court.

In preparing the transcript of the record in the above-entitled cause to be filed in the office of the clerk of the United States Circuit Court of Appeals for the Eighth Circuit under the appeal heretofore taken by United States of America as appellant vs. Guaranty Trust Company et al., as appellees, which appeal was allowed by the District Court of the United States for the District of Minnesota, Fourth Division, you will please include in said transcript, in addition to the papers, orders, records, and proceedings required by the præcipe heretofore filed herein by the United States of America, the following:

1. That certain statement of evidence contained in stipulation dated September 12, 1928, and approved by the above-named court and filed in your office on the 20th day of September, 1928.

Said transcript to be prepared as required by law and the requirements of the United States Circuit Court of Appeals for the Eighth

Circuit and the rules of practice for the courts of equity of the United States.

FOWLER, CARSON, FURBER & JOHNSON,
By RALPH H. COMAFORD
Attorneys for H. H. Sheriff, Intervener.

100 Service of a copy of the foregoing præcipe is acknowleged this 13th day of September, 1928.

Cook, Nathan & Lehman, O'Brien, Horn & Stringer, *Attys., Bache Committee;* Cadwalader, Wickersham & Taft, Sanborn, Graves & Andre, *attys., Perkins Committee;* Cobb, Hoke, Benson, Krause & Faegre, *attys., Mpls. Steel & Mach. Co.;* Washburn, Bailey & Mitchell, by Fowler, Carlson, Furber & Johnson, *attys., Duluth Boiler Works;* Fowler, carlson & Johnson, by Ralph H. Comaford, *attys., H. H. Sheriff et al.;* J. H. Mulally, *attys., Great Northern Ry. Co.;* Donald Evans, *solicitor, M. & St. L. R. R. Co.;* M. M. Joyce, *counsel for receiver, M. & St. L. R. R. Co.;* William J. Donovan, Elmer B. Collins, *attys., United States of America;* C. W. Bunn, *attys., Northern Pacific Ry. Co.;* Davis, Polk, Wardwell, Gardiner & Reed, Davis, Severance & Morgan, Winston, Strawn &
101 Shaw, *attys., Guaranty Trust Co.;* Larkin, Rathbone & Perry, Frederick G. Ingersoll, *attys., Central Union Trust Co.;* Alexander & Green, Doherty, Rumble, Bunn & Butler, *solicitors, Bankers Trust Co.;* Taylor Blanc, Capron & Marsh, Boyesen, Otis, Brill & Faricy, *solicitors, Farmers Loan & Trust Co.;* White & Case, Kingman, Cross, Morley & Cant, *attys., New York Trust Co. and Bennett Committee.*

[File indorsement omitted.]

In United States District Court

[Title omitted.]

Stipulation as to statement of evidence

Filed Sept. 20, 1928

It is hereby stipulated by and between United States of America, appellant in the appeal heretofore taken herein by said United States of America to the United States Circuit Court of Appeals for the Eighth Circuit, and Guaranty Trust Company et al., appellees in said appeal, through their respective attorneys, that the evidence in the above-entitled cause shows, among other things, the following:

That the note in the amount of $386,190.00 upon which was based item 2 of claim #2700 of the United States of America was secured

by deferred lien certificates issued under a certain equipment trust agreement, Series A, lease basis, dated June 1, 1921, executed by the National Railway Service Corporation to the Bankers
102 Trust Company of New York as trustee and that under and by the terms of said agreement there were created two classes of lien certificates, viz: "Prior lien certificates" and "deferred lien certificates," and that the "deferred lien certificates" were deferred to the "prior lien certificates" as to security.

It is further stipulated that the foregoing statement of evidence may be submitted to the above-named court and be by it approved and filed without further notice to any of the parties hereto.

Dated September 12, 1928.

Cook, Nathan & Lehman, O'Brien, Horn & Stringer, attys., Bache Committee; Cadwalader, Wickersham & Taft, Sanborn, Graves & Andre, attys., Perkins Committee; Cobb, Hoke, Benson, Krause & Faegre, attys., Mpls. Steel & Mach. Co.; Washburn, Bailey & Mitchell, by Fowler, Carlson, Furber & Johnson, attys., Duluth Boiler Works; Fowler, Carlson, Furber & Johnson, by Ralph H. Comaford, attys., H. H. Sheriff et al.; J. H. Mulally, atty., Great Northern Ry. Co.; Donald Evans, solicitor, M. & St. L. R. R. Co.; M. M. Joyce, counsel for receiver, M. & St. L. R. R. Co.; William J. Donovan, Elmer B. Collins,
103 attorneys for United States of America; C. W. Bunn, attorneys, Northern Pacific Ry. Co.; Davis, Polk, Wardwell, Gardiner & Reed, Davis, Severence & Morgan, Winston, Strawn & Shaw, attys., Guaranty Trust Co.; Larkin, Rathbone & Perry, Frederick G. Ingersoll, attys., Central Union Trust Co.; Alexander & Green, Doherty, Rumble, Bunn & Butler, solicitors, Bankers Trust Co.; Taylor, Blanc, Capron & Marsh, Boyesen, Otis, Brill & Faricy, solicitors, Farmers Loan & Trust Co.; White & Case, Kingman, Cross, Morley & Cant, attys., New York Trust Co., and Bennett Committee.

Order approving statement of evidence

I hereby approve the foregoing statement of evidence and direct the clerk to file the same.

WILBUR F. BOOTH,
United States Circuit Judge, Acting by Assignment.

104 [Clerk's certificate to foregoing transcript omitted in printing.]

In United States Circuit Court of Appeals, Eighth Circuit

No. 8389

UNITED STATES OF AMERICA, APPELLANT,

vs.

GUARANTY TRUST COMPANY ET AL.

Appeal from the District Court of the United States for the District of Minnesota

Order advancing cause to docket of December term, 1928, etc.

Upon consideration of the stipulation of counsel for the respective parties in this cause for an order forthwith placing
105 this appeal upon the calendar for trial at the December term 1928 of this court notwithstanding the failure to file the transcript of the record from the District Court with the clerk of this court before the close of the docket for the said December term, and for good cause shown, it is now here ordered by this court that this cause be, and the same is hereby, advanced to the calendar of the December term, 1928, of this court and set for hearing at the foot of the call for the week beginning Monday, January 7, 1929.

OCTOBER 26, 1928.

106–111 [Appearances of counsel omitted in printing.]

112 [Minute entry of argument and submission, Jan. 16, 1929, omitted in printing.]

113 In United States Circuit Court of Appeals

Order substituting Kalbach et al., executors, in lieu of appellee, Sheriff, deceased

January 15, 1929

In this cause the death of H. H. Sheriff, an intervener, one of the appellees, is suggested by Mr. H. C. Carlson, one of the attorneys for appellees herein, and upon his application for substitution, opposing counsel being present in court and not objecting, it is ordered by this court that W. H. Kalbach and Clara Sheriff, as executors of the estate of H. H. Sheriff, deceased, be, and they are hereby substituted as appellees in the place and stead of said H. H. Sheriff, deceased.

114 In United States Circuit Court of Appeals,
Eighth Circuit

No. 8389. May term, A. D. 1929

UNITED STATES OF AMERICA, APPELLANT vs. GUARANTY TRUST COMPANY OF NEW YORK, as Trustees, et al., appellees	Appeal from the District Court of the United States for the District of Minnesota

Before VAN VALKENBURGH and COTTERAL, Circuit Judges, and SCOTT, District Judge

Opinion

(Filed May 15, 1929)

VAN VALKENBURGH, Circuit Judge, delivered the opinion of the court.

115 The Minneapolis and St. Louis Railroad Company is in the hands of a receiver appointed in the District Court for the District of Minnesota, July 26, 1923, upon the application of certain creditors.

Subsequently actions were instituted for the foreclosure of mortgages, and these actions were consolidated with the suit instituted by the creditors' bill. These mortgages were made at various dates between 1888 and 1912, and are conceded to be valid and subsisting record liens upon the properties of the railroad mortgagor. During the progress of the receivership, not yet closed, it has been developed that there are numerous preferred creditors—that is to say, those whose claims arose as a current expense of ordinary operation of the railroad, where necessary for the preservation of the road and to the business of the road, were contracted with the expectation and intention of the parties that they were to be paid out of the current earnings of the road, and accrued within six months prior to the appointment of the receiver. In addition there are unsecured and general creditors. This appeal involves the Government's claim of priority over all creditors, secured and unsecured, by virtue of the provisions of section 3466 R. S. (Comp. Stat. 1916, sec. 6372), to wit:

"Whenever any person indebted to the United States is insolvent, or whenever the estate of any deceased debtor, in the hands of the executors or administrators, is insufficient to pay all the debts due from the deceased, the debts due to the United States shall be first satisfied; and the priority hereby established shall extend as well to cases in which the debtor, not having sufficient property to pay all his debts, makes a voluntary assignment thereof, or in which the

estate and effects of an absconding, concealed, or absent debtor are attached by process of law, as to cases in which an act of bankruptcy is committed."

The claims of the United States, appellant, involved herein are four in number and are thus described:

Claim 2700

Item One. This item consists of a loan in the principal amount of $1,382,000 from the Secretary of the Treasury to the Minneapolis & St. Louis Railroad Company under section 210, transportation act, 1920, as amended, and certificate No. 81 of the Inter-
116 state Commerce Commission, evidenced by a promissory note executed by the railroad company on April 1, 1921, due April 1, 1931, with interest at 6 per cent per annum, payable semi-annually.

Item Three. This item consists of a principal sum of $625,000 indebtedness of the railroad to the United States at the termination of Federal control, funded pursuant to the provisions of section 207, transportation act, 1920, evidenced by the railroad company's promissory note acquired by the Director General of Railroads, dated May 27, 1922, with interest at 6 per cent per annum, payable semiannually.

Item Four. This item is also in the principal amount of $625,000 representing further indebtedness of the railroad company to the United States at the termination of Federal control, funded pursuant to the provisions of section 207, transportation act, 1920, and is evidenced by a promissory note executed by the Director General of Railroads, dated April 2, 1923, due on demand with interest at 6 per cent per annum, payable semiannually.

Claim 4186

This claim is in the sum of $292,022.23, together with interest thereon at 6 per cent per annum from May 28, 1921, representing an overpayment of advances to the railroad company under the guaranty provisions of section 209, transportation act, 1920, that amount having been certified by the Interstate Commerce Commission on April 14, 1924, as paid in excess of the amount guaranteed."

The master found against the Government as to the preferential status of all four claims. Upon exceptions, the court sustained the master. With respect to each of items 1, 3, and 4 of Claim 2700, the following language was used:

"The whole of this amount is allowed as a general claim only, and is ordered to be paid pro rata with other claims of like general status from such funds, if any, in the hands of the court in this cause as may now or hereafter be available for that purpose, without any preference or priority either against the corpus of the mortgaged property or in relation to any other claim or class of claims duly filed in this cause."

117 Claim 4186 was thus disposed of:

"The claim (master's No. 4186) of the United States against the Minneapolis & St. Louis Railroad Company as set forth in the report of the special master is hereby adjudged to have no preferential status, this being the only question relative to said claim submitted for determination."

Inasmuch as these rulings finally dispose of the preferential status of these specific liquidated claims presented for allowance and ultimate payment as such, this appeal is not premature. An allowance or disallowance usually settles the status of a claim, even though, in any event, it may not be entitled to immediate payment. City and County of Denver v. Stenger (C. C. A. 8), 295 Fed. 809, 814.

Let us first consider the nature of these governemntal claims and the terms of the statute under which the indebtedness accrued. Item one of claim 2700, as stated, consists of a loan made by the Government to the railroad under the provisions of section 210 of the transportation act of 1920, as amended. Paragraph "A" of section 210 provides as follows:

"For the purpose of enabling carriers by railroad subject to the interstate commerce act properly to serve the public during the transition period immediately following the termination of Federal control, any such carrier may, at any time after the passage of this act and before the expiration of two years after the termination of Federal control, make application to the commission for a loan from the United States, setting forth the amount of the loan and the term for which it is desired, the purpose of the loan, and the uses to which it will be applied, the present and prospective ability of the applicant to repay the loan and meet the requirements of its obligations in that regard, the character and value of the security offered, and the extent to which the public convenience and necessity will be served. The application shall be accompanied by statements showing such facts and details as the commission may bequire with respect to the physical situation, ownership, capitalization, indebtedness, contract obligations, operation, and earning power of the applicant, together with such other facts relating to the propriety and expediency of granting the loan applied for and

118 the ability of the applicant to make good the obligation, as the commission may deem pertinent to the inquiry."

Paragraph "B" provides that the commission, after such hearing and investigation, "may certify to the Secretary of the Treasury its findings of fact and its recommendations as to the amount of the loan which is to be made; the time, not exceeding five years from the making thereof, within which it is to be repaid; the character of the security which is to be offered therefor; and the terms and conditions of the loan."

By paragraph "E" $300,000,000 is appropriated to be used as a revolving fund for the purpose of making the loans provided for in this section.

The master details the circumstances under which this claim arose. Six per cent gold bonds of the Minneapolis & St. Louis Railroad Company in the amount of $1,382,000, secured by mortgage known as the Pacific Extension mortgage, matured April 1, 1921. To meet this the United States, under the provisions of section 210, advanced to the railroad $1,382,000, payable in ten years, and on the same date the railroad executed and delivered the promissory note which forms the basis of item one of claim 2700. At the same time $2,377,000 par value of the Minneapolis & St. Louis refunding and extension bonds were deposited as collateral for this loan.

Item three of claim 2700 is thus stated in the findings of the master:

"Item 3 (Government's Exhibit No. 1) of this claim is a promissory note for $625,000.00 given to the Director General of Railroads by the Minneapolis & St. Louis Railroad Company, dated May 27, 1922, due March 1, 1930, and with interest at the rate of 6% per annum, payable semiannually on the 1st days of April and October in each calendar year until payment of said principal sum. This obligation represents indebtedness incurred in the operation of the Minneapolis & St. Louis Railroad Company to the United States of America due at the termination of Federal control and which was funded pursuant to the provisions of section 207 of the transportation act, 1920. This note was secured by a deposit of collateral of $1,500,000.00, principal amount of the refunding and
119 extension mortgage, 50 year, Series 'A,' 5% gold bonds of the Minneapolis & St. Louis Railroad Company, dated January 1, 1912, and due in 1962."

The finding with respect to item four is substantially identical as to origin and security. The date of the note given thereunder was April 1, 1923. These two items arose under the provisions of section 207 of the transportation act of 1920. Paragraph "A" of that section provides that—

"As soon as practicable after the termination of Federal control the President shall ascertain (1) the amount of the indebtedness of each carrier to the United States which may exist at the termination of Federal control, incurred for additions and betterments made during Federal control and properly chargeable to capital account; (2) the amount of indebtedness of such carrier to the United States otherwise incurred; and (3) the amount of the indebtedness of the United States to such carrier arising out of Federal control," in order that certain rights of set-off, together with other adjustments stated, may be made.

Paragraph "B" then provides further as follows:

"Any remaining indebtedness of the carrier to the United States in respect to such additions and betterments shall, at the request of the carrier, be funded for a period of ten years from the termination of Federal control, or a shorter period at the option of the carrier, with interest at the rate of 6 per centum per annum, payable semiannually, subject to the right of such carrier to pay on any

interest-payment day the whole or any part of such indebtedness. Any carrier obtaining the funding of such indebtedness as aforesaid shall give, in the discretion of the President, such security in such form and upon such terms as he may prescribe."

Claim No. 4186 arises under section 209 of the transportation act. By that section for the period of six months after the termination of Federal control, said six months beginning March 1 1920, the United States guaranteed to the carriers in general that their railway operating income for such guaranteed period as a whole should not be less than one-half the average annual railway operating income of such carrier during a test period defined to mean the three years ending June 30, 1917. The terms of this guar-
120 anty varied with respect to the status of the carrier and the relationship existing between it and the Government during the period of Federal control. Paragraph "G" of this section provides—

"The commission shall, as soon as practicable after the expiration of the guaranty period, ascertain and certify to the Secretary of the Treasury the several amounts necessary to make good the foregoing guaranty to each carrier. The Secretary of the Treasury is hereby authorized and directed thereupon to draw warrants in favor of each such carrier upon the Treasury of the United States for the amount shown in such certificate as necessary to make good such guaranty. An amount sufficient to pay such warrants is hereby appropriated out of any money in the Treasury not otherwise appropriated."

Paragraph "H" provides for advancements to the carrier from time to time upon application to the Interstate Commerce Commission of sums not in excess of the estimated amount necessary to make good the guaranty and necessary to enable it to meet its fixed charges and operating expenses; and further, that upon final determination of the amount of the guaranty provided the carrier will repay to the United States any amounts which it may have received from such advancements in excess of the guaranty.

Claim No. 4186, as found by the master, is based upon an alleged indebtedness to the United States, as evidenced by a determination of the Interstate Commerce Commission, in the sum of $292,022.23. It is claimed that an aggregate amount of $2,150,000 was certified for payment as advances under paragraph "H," and that $490,000 additional was certified as a partial payment under paragraph "G." The total amount found by the commission as necessary to make good the guaranty was $2,347,977.77. The difference between the advancements and this latter figure represents the overpayment by the Government in connection with the adjustment of accounts with respect to this guaranty. The formula followed by the commission in arriving at the amount of the guaranty is disputed by the railroad and its receiver, and, therefore, the court below passed only upon the preferential status of the claim and not upon its amount.

To these claims of the United States a twofold defense is presented for consideration: (a) That of the mortgagees, or
121 lienors, and (b) that of the priority creditors, as hereinabove defined, who claim an equitable lien superior to all other demands represented. Of these in their order—

(a) The mortgage trustees, appellees herein, defend upon the ground that the priority claim of the Government, even though applicable in any sense, is inferior to the mortgage lien of the bondholders. They take the position announced in United States v. Duncan, Federal Case 15,003:

"It has been uniformly held in all the cases that the priority of the United States does not disturb any specific lien, nor the perfected lien of a judgment, that it does not supersede a mortgage on land, nor a judgment made perfect by the issue of an execution and a levy on land. Thelluson v. Smith, 2 Wheat. 396; Conrad v. Atlantic Ins. Co., 1 Pet. 286."

To the same effect is United States v. Lewis, Fed. Case 15,595; United States v. Hooe, 3 Cranch. 78; Field v. United States, 9 Peters, 182, 200; Brent v. Bank of Washington, 10 Peters, 596; and 9 Opinions of Attorney General 28. The contention of the Government is that the doctrine announced by the decisions just cited, upon which appellees rely, was dictum merely, and therefore not entitled to weight as a determination by the Supreme Court; further, that these earlier decisions were based upon the status of a mortgage at that time as a conveyance and transfer of the title, whereas the modern view is that the title remains in the mortgagor, the mortgagee having but a lien. It is pointed out that those decisions were handed down during the period between 1805 and 1840; that as early as in 1863 the Supreme Court, in Hutchins v. King, 1 Wall. 53, called attention to the modification of the old rule respecting the effect of a mortgage of real estate; and that in Waterman v. Mackenzie, 138 U. S. 252, the court in 1891 announced the modern rule.

With respect to the first of these propositions it may be said that while, strictly speaking, the rule announced by the Supreme Court in a number of these cases may be regarded as dictum, nevertheless the reannouncement of the doctrine repeatedly over a period of more than a hundred years serves to establish it, not only as the consistent view of the court, but also as a rule of property upon
122 which practical transactions have been and are being based.

The attitude of the Supreme Court has not been changed since the advent of what appellant calls the "modern rule" concerning the effect of a mortgage of real estate. In 1897, in Savings Society v. Multnomah County, 169 U. S. 421, 428, it said:

"This court has always held that a mortgage of real estate, made in good faith by a debtor to secure a private debt, is a conveyance of such an interest in the land as will defeat the priority given to the United States by act of Congress in the distribution of the debtor's estate."

The same principle is recognized in Marshall v. New York, 254 U. S. 380, decided in 1920, and also in Waterman v. Mackenzie, supra, cited by appellant as announcing the modern rule in 1891, to wit, "a mortgage is everywhere considered as passing the title in the land, so far as may be necessary for the protection of the mortgagee, and to give him the full benefit of his security." We deem it to be established beyond dispute that priority claims of the United States, under section 3466 R. S., are subordinate to the lien of a mortgage which has attached before the indebtedness to the Government accrues.

(b) The questions involved in the defense made on behalf of the preferred creditors are serious ones. The priority conferred by section 3466 has been rigidly enforced in the decisions of the Supreme Court and other national courts. It is generally held that the statute is to be liberally construed in favor of the United States, and, together with section 3467, which designates the persons answerable for failure to observe the law requiring priority payment to the United States under prescribed circumstances, means "that a debt due the United States is required first to be satisfied when the possession and control of the estate of the insolvent is given to any person charged with the duty of applying it to the payment of the debts of the insolvent, as the rights and priorities of creditors may be made to appear." Bramwell v. U. S. Fidelity Co., 269 U. S. 483, 490; Price, Receiver, v. United States, 269 U. S. 492; United States v. Butterworth, 269 U. S. 504.

It is further held that, in taking over and operating the railroad systems of the country, the United States did so in its sovereign
123 capacity as a war measure, and may not be held to have waived any sovereign right or privilege unless plainly so provided. DuPont De Nemours & Co. v. Davis, 264 U. S. 456, 462. However, in Mellon v. Michigan Trust Co., 271 U. S. 236, 239, it is said that while "in taking over and operating the railroads the United States acted in their sovereign capacity," nevertheless "all agree that the rights of the director general rest upon statutory provisions and not upon any sovereign prerogative of the United States." Therefore, "it was for Congress to determine whether or not claims arising out of such operation should have priority when the debtor made a voluntary assignment. In cases of bankruptcy the statute then in force prohibited any preference."

The claims in Mellon v. Michigan Trust Company arose out of operation under the Federal control act (40 Stat. 451, 456). The director general presented claims for transportation charges and conversion of a shipment of pig iron, and asked priority of payment. It was held that he was not entitled to this under paragraph 3466 in view of paragraph 10 of the control act, which, so far as pertinent here, reads as follows:

"That carriers while under Federal control shall be subject to all laws and liabilities as common carriers, whether arising under State or Federal laws or at common law, except in so far as may be

inconsistent with the provisions of this act or any other act applicable to such Federal control or with any order of the President. Actions at law or suits in equity may be brought by and against such carriers and judgments rendered as now provided by law, and in any action at law or suit in equity against the carrier no defense shall be made thereto upon the ground that the carrier is an instrumentality or agency of the Federal Government."

The court in its opinion said:

"In some matters, at least, under paragraph 10, the United States stands exactly as if they were a railroad corporation operating as a common carrier. Director General v. Kastenbaum, 263 U. S. 25, 28. As said in Davis v. Pullen, 277 Fed. 650, 655, 'there is a certain obvious injustice in giving the United States when engaged in an industrial and commercial venture, even although under war powers, superior rights over other creditors bearing like relations to
124 insolvents.' And we think that the indicated purpose of Congress will be best carried out by construing the relevant statutes, so far as may be, with the general intent to preserve the substantive rights of all parties concerned as they would have existed but for Federal control."

The decision in Mellon v. Michigan Trust Company affirms the judgment of the Circuit Court of Appeals of the Seventh Circuit in Davis v. Michigan Trust Company, 2 Fed. (2d) 194. The controversy arose in a general equity proceeding where, as here, a receiver was appointed under circumstances sufficient to make such appointment an act of bankruptcy. Insolvency in the bankruptcy sense was not alleged, but, as here, insolvency in the sense of section 3466 was present. Neither was the jurisdiction of the bankruptcy court invoked, nor did it attach. In deciding that the director general was not entitled to assert governmental priority over other creditors on claims arising out of governmental operation of railroads, the Circuit Court of Appeals used this language:

"Giving due regard to the expression of congressional policy of priority, on the one hand, and of a restriction to the rights that the carrier theretofore enjoyed, on the other hand, and on a careful balancing of conflicting interests, we believe that, especially in the light of the policy of the present bankruptcy act as interpreted by the Chief Justice, supra, priority must be denied to the director general in this case."

Neither the bankruptcy act nor paragraph 10 of the Federal control act in express terms excludes the application of section 3466 to the case under consideration. The decision was reached by both courts through construction, which gave due regard to the indicated policy and purpose of Congress as revealed in the Federal control act.

We feel that the transportation act continued in force to a large extent the relationships, responsibilities, and obligations created and imposed by the former act and added others essential to the adjust-

ments incidental to the termination of Federal control. It was the announced policy of the United States, as revealed in this act, to see to it that the roads were sustained and that transportation was insured during the period following governmental operation,
125 at which time serious disorganization existed, and the carriers were known to be in a very unstable financial condition. Much in the way of betterments had immediately to be provided. The morale was greatly impaired. Public confidence was in some measure diminished, and it was realized that the railroads could with difficulty, if at all, secure sufficient new capital to meet their necessities. These provisions of the transportation act were intended to supply such as could not be procured from private sources. We think there is great force in the contention that the Government, by thus encouraging private capital to come to the support of the carriers, thrown upon their own resources, at the termination of an extended period of Federal control, and at the close of an exhausting World War, and by inviting credit to be given for current materials and supplies, presumably upon the same terms, security, and protection afforded and long recognized with respect to railroad operations, has placed itself in a position where it is estopped to seek priority over those who have advanced money and furnished supplies under conditions which entitle them to a preferential status.

In a given case it is for Congress to determine whether section 3466 should apply. The Supreme Court, in Mellon v. Michigan Trust Company, held that, under the indicated purpose of Congress as expressed in paragraph 10 of the Federal control act, the United States was not entitled to the priority granted by section 3466. We think the same construction should be accorded to the transportation act. In our judgment this language of the opinion in the Mellon case "that the indicated purpose of Congress will be best carried out by construing the relevant statutes, so far as may be, with the general intent to preserve the substantive rights of all parties concerned as they would have existed but for Federal control," is equally appropriate here. We think, therefore, that the rights of the priority creditors are superior to the claims of appellant. Those rights constitute equitable liens upon the estate to the extent of any net income of the receiver and unmortgaged assets; and, in case of diversion of net operating income, during the six months' period prior to receivership, to the payment of accruing interest on mortgage indebtedness or to capital account expenditure, those preferred rights may extend to the corpus itself. Brent v. The Bank of Washington, 10 Peters, 569; Fosdick v. Schall, 99 U. S. 252; Burn-
126 ham v. Bowen, 111 U. S. 776; Gregg v. Metropolitan Trust Co., 197 U. S. 183; Moore v. Donahoo (C. C. A. 9), 217 Fed. 177; Illinois Trust & Savings Bank v. Doud (C. C. A. 8), 105 Fed. 123; Chicago & Alton R. Co. v. U. S. & Mexican Trust Co. (C. C. A. 8), 225 Fed. 940. And these equitable liens may be enforced independently of foreclosure proceedings. Moore v. Donahoo, supra, l. c. 183.

Holding, as they do, preferred rights under certain conditions over mortgages of record, it would seem illogical that they should be displaced by this governmental claim of priority, which, we think, is clearly inferior to the mortgage liens. These equitable rights attached and were a subsisting charge upon the assets of the railroad before the United States, in any view, was in a position to assert and enforce its claims. Marshall, Receiver, v. People of the State of New York, 254 U. S. 380.

There are other reasons why appellant should not prevail in this action. The Government, in making these loans and advancements as a sequence to its operation of the roads during the war period, engaged in private business quite as substantially as it is held to have done under the Federal contract act. Furthermore, the transportation act provided for the taking of security for loans made and for money advanced, and such security was taken in three of the four transactions under consideration. The act, therefore, is self-contained and sufficient unto itself without reliance upon section 3466 or any other statutory provision. The conditions surrounding these transactions differ in no substantial respect from those occurring in business between private parties, and should be governed by no other rules. United States v. Miller (C. C. A. 8), 28 Fed. (2d) 846, 850.

The decree below adjudged claim 4186 to have no preferential status, and that the three items of claim 2700 should be "without any preference or priority either against the corpus of the mortgaged property or in relation to any other claim or class of claims duly filed in this cause."

Inasmuch as only holders of liens legal and equitable are before us on this appeal, and since it is conceded that the estate will not realize more than enough to discharge the mortgage indebtedness and preferred claims, we find it unnecessary to consider the effect
127 of the decretal order upon general creditors. It follows from what has been said that the decree should be and is affirmed.

128 In United States Circuit Court of Appeals Eighth Circuit

No. 8389

UNITED STATES OF AMERICA, APPELLANT

vs.

GUARANTY TRUST COMPANY OF NEW YORK, AS TRUSTEE; MINNEAPOLIS Steel and Machinery Company; Duluth Boiler Works, Intervener, et al.; Minneapolis and St. Louis Railroad Company, H. H. Sheriff, Intervener, et al.; Great Northern Railway Company; New York Trust Company and Bennett Committee; Central Union Trust Company; Bankers Trust Company; Farmers Loan and Trust Company; Northern Pacific Railway Company; Perkins Committee; Bache Committee; W. H. Bremner, receiver of the Minneapolis and St. Louis Railroad Company; W. H. Kalbach and Clara

Sheriff, as executors of the estate of H. H. Sheriff, deceased, substituted in the place and stead of said H. H. Sheriff, deceased

Appeal from the District Court of the United States for the District of Minnesota

Decree

May 15, 1929

This cause came on to be heard on the transcript of the record from the District Court of the United States for the District of Minnesota, and was argued by counsel.

On consideration whereof it is now here ordered, adjudged, and decreed by this court that the decree of the said District Court in this cause be, and the same is hereby, affirmed without costs to either party in this court.

129 In United States Circuit Court of Appeals Eighth Circuit

Clerk's certificate

I, E. E. Koch, clerk of the United States Circuit Court of Appeals for the Eighth Circuit, do hereby certify that the foregoing contains the transcript of the record from the District Court of the United States for the District of Minnesota as prepared and printed under the rules of the United States Circuit Court of Appeals for the Eighth Circuit, under the supervision of its clerk, and full, true, and complete copies of the pleadings, record entries, and proceedings, including the opinion, had and filed in the United States Circuit Court of Appeals, except the full captions, titles, and endorsements omitted in pursuance of the rules of the Supreme Court of the United States, in a certain cause in said Circuit Court of Appeals wherein the United States of America was appellant and Guaranty Trust Company of New York, as Trustee, et al., were appellees, No. 8389, as full, true, and complete as the originals of the same remain on file and of record in my office.

I do further certify that on the twenty-third day of July, A. D. 1929, a mandate was issued out of the said Circuit Court of Appeals in said cause, directed to the judges of the District Court of the United States for the District of Minnesota.

In testimony whereof I hereunto subscribe my name and affix the seal of the United States Circuit Court of Appeals for the Eighth Circuit at office in the city of St. Louis, Missouri, this ninth day of August, A. D. 1929.

[SEAL.]

E. E. Koch,
Clerk of the United States Circuit Court of Appeals for the Eighth Circuit.

130 In Supreme Court of the United States

Petition for an extension of time within which to file petition for writ of certiorari

Filed Aug. 13, 1929

To the Honorable Willis Van Devanter,
Associate Justice of the Supreme Court of the United States:

Your petitioner, United States of America, respectfully presents this, its application for an extension of time within which to file a petition for a writ of certiorari in this honorable court in the above-entitled cause, and in support thereof presents the following:

I

The case involves the question whether the United States is entitled under section 3466, Revised Statutes, to priority over other creditors in payment of debts due it by the Minneapolis & St. Louis Railroad Company, against which company receivership and foreclosure proceedings were brought, in the course of which the debts due the United States were duly proved as claims against that company.

These claims were based upon a loan for $1,382,000 made to the carrier pursuant to section 210 of the transportation act, 1920; advancements of cash and other indebtedness of the carrier accruing to the Government during Federal control, funded in two notes of $625,000 each, pursuant to section 207 of the same act; and an overpayment by the Government of advances in amount of
131 $292,022.23 to the carrier, upon certificate of the Interstate Commerce Commission, under the guaranty provisions of section 209 of that act. The district court held that the Government claims were entitled to no priority as against (1) claims of mortgage creditors, (2) priority claims in receivership, or (3) claims of general creditors. The Circuit Court of Appeals affirmed, except that it found it unnecessary to determine priority as against general creditors. It is understood that the same questions are involved in the cases of several other railroads, and petitioners therefore believes that it would be desirable to have the law settled by this court.

II

The final decree of the Circuit Court of Appeals for the Eighth Circuit was entered on May 15, 1929, and the time for filing the petition for a writ of certiorari will expire August 15, 1929.

The work on this case has been handled by the antitrust division of the Department of Justice. Owing to the change of administration, there have been an unusually large number of resignations and vacancies in the staff of that division, and there is now but one lawyer at present available for the cases arising under the act to regulate commerce, the transportation act, and the other acts re-

lating to common carriers. This situation, coupled with the exigent requirements of other work in that division, has made it impossible for it to prepare with the necessary care a petition for certiorari. As shown by the opinion below, the record presents a variety of difficult questions. Certain points have also recently been suggested which require study and consideration which it will be impossible to complete prior to the expiration of time on August 15th.

132 In view of the foregoing, your petitioner believes that an additional extension of one month will be necessary for the adequate preparation of the petition.

Wherefore your petitioner respectfully prays that the time within which petition for a writ of certiorari in the above-entitled cause may be filed in this honorable court be extended to and including September 15, 1929.

CHARLES E. HUGHES, Jr.,
Solicitor General.

133 In Supreme Court of the United States

Order extending time within which to apply for writ of certiorari

Filed Aug. 13, 1929

On consideration of the petition of the Solicitor General of the United States in the above-entitled cause, and good cause therefor having been shown,

It is now here ordered that the time within which petition for writ of certiorari may be filed herein be, and the same is hereby, extended until September 17th, 1929.

WILLIS VAN DEVANTER,
Associate Justice of the Supreme Court of the United States.

Dated this 10th day of August, 1929.

134 [File indorsement omitted.]

135 Supreme Court of the United States

Order allowing certiorari

Filed October 21, 1929

The petition herein for a writ of certiorari to the United States Circuit Court of Appeals for the Eighth Circuit is granted. And it is further ordered that the duly certified copy of the transcript of the proceedings below which accompanied the petition shall be treated as though filed in response to such writ.

[Indorsement on cover:] File No. 34,533. U. S. Circuit Court of Appeals, Eighth Circuit. Term No. 402. The United States of America, petitioner, vs. Guaranty Trust Company of New York et al. Petition for writ of certiorari and exhibit thereto. Filed September 17, 1929. File No. 34,533.

○

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CHARLES ELMORE

No. 402

In the Supreme Court of the United States

OCTOBER TERM, 1929

UNITED STATES OF AMERICA, PETITIONER

v.

GUARANTY TRUST COMPANY OF NEW YORK, ET AL.

PETITION FOR A WRIT OF CERTIORARI TO THE UNITED STATES CIRCUIT COURT OF APPEALS FOR THE EIGHTH CIRCUIT, AND BRIEF IN SUPPORT THEREOF

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70589—29——1

In the Supreme Court of the United States

OCTOBER TERM, 1929

No. ——

UNITED STATES OF AMERICA, PETITIONER

v.

GUARANTY TRUST COMPANY OF NEW YORK, ET AL.

PETITION FOR A WRIT OF CERTIORARI TO THE UNITED STATES CIRCUIT COURT OF APPEALS FOR THE EIGHTH CIRCUIT, AND BRIEF IN SUPPORT THEREOF

PETITION

The Solicitor General, on behalf of the United States, prays that a writ of certiorari issue to review the decree of the Circuit Court of Appeals for the Eighth Circuit entered in the above-entitled cause on May 15, 1929 (R. 118–119) affirming the decree of the District Court of the United States for the District of Minnesota (R. 85).

STATEMENT

The question involved is whether, in the distribution of the assets of an insolvent railroad company in receivership, the United States is entitled under Section 3466 R. S. to priority in payment of debts

due it from that company over other creditors; namely, (1) mortgage trustees, (2) preferred creditors, and (3) general unsecured creditors, or any of them.

The Minneapolis & St. Louis Railroad Company is in the hands of a receiver appointed by the District Court of the United States for the District of Minnesota, July 26, 1923, upon the application contained in a creditor's bill alleging its insolvency. The fact was admitted by the Railroad Company's answer. (R. 1–3.) Subsequently suits were instituted for the foreclosure of mortgages on the property, and were consolidated with the suit begun upon the creditor's bill.

The mortgages in question were made at various dates between 1888 and 1912, which was before the indebtedness to the United States was incurred. (R. 110.) Other claims which the court treated as preferred are those which arose as a current expense of ordinary operation of the Railroad, were necessary for the preservation of the road and the business of the road, were contracted with the expectation and intention of the parties that they were to be paid out of the earnings of the road, and accrued within six months prior to the appointment of the Receiver. (R. 110.)

Prior to the receivership the Railroad Company became indebted to the United States under the provisions of Sections 210, 207 and 209, of the Transportation Act of 1920, in principal amounts aggregating about $3,000,000 under the circumstances set forth in the following paragraphs which

describe the claims by numbers assigned to them in the District Court (R. 5–12) and by which they are identified in the opinion of the Circuit Court of Appeals.

Claim 2700

Item One.—Loan in the principal amount of $1,382,000 from the Secretary of the Treasury to the Minneapolis & St. Louis Railroad Company under Section 210, Transportation Act, 1920, as amended, and Certificate No. 81 of the Interstate Commerce Commission, evidenced by a promissory note executed by the Railroad Company on April 1, 1921, due April 1, 1931, with interest at 6 per cent per annum, payable semiannually.

Item Three.—$625,000 indebtedness of the railroad due to the United States, at the termination of Federal control, funded pursuant to the provisions of Section 207, Transportation Act, 1920, evidenced by the Railroad Company's promissory note acquired by the Director General of Railroads, dated May 27, 1922, due March 1, 1930, with interest at 6 per cent per annum, payable semiannually.

Item Four.—$625,000 representing further indebtedness of the Railroad Company due to the United States at the termination of Federal control, funded pursuant to the provisions of Section 207, Transportation Act, 1920, and evidenced by a promissory note executed by the Railroad Company and acquired by the Director General of Railroads, dated April 2, 1923, due on demand with interest at 6 per cent per annum, payable semiannually.

Claim 4186

> $292,022.23, together with interest thereon at 6 per cent per annum from May 28, 1921, representing an overpayment of advances to the Railroad Company under the guaranty provisions of Section 209, Transportation Act, 1920, that amount having been certified by the Interstate Commerce Commission on April 14, 1924, as paid in excess of the amount guaranteed.

Certain Minneapolis & St. Louis Railroad Refunding and Extension bonds were deposited as collateral for some of this indebtedness. The mortgage under which these bonds were issued was junior to the mortgages under which the mortgage trustees claimed in the instant suit, as to practically all of the property covered by the latter.

The claims of the United States were duly proved to the District Court and were allowed by it with interest to date of the receivership (R. 87–88), except Claim No. 4186, concerning which only the question of priority and not the amount was determined by that court.

The United States claimed priority under Section 3466 R. S. in payment of each of these claims. The District Court, however, allowed three of the claims as general claims only, to be paid pro rata with other claims, "without any preference or priority either against the corpus of the mortgaged property or in relation to any other claim or class

of claims," and held that the fourth claim had "no preferential status." (R. 86–87.) The decree of the District Court was affirmed by the Circuit Court of Appeals for the Eighth Circuit, and it is to review the decree of the Circuit Court of Appeals, entered May 15, 1929, that the writ of certiorari is now sought.

SPECIFICATION OF ERRORS

The Circuit Court of Appeals erred:

I. In holding that Section 3466 R. S. did not apply to claims arising under the transportation Act of 1920.

II. In holding that the claims of the United States are not entitled to priority over the claims of the mortgage trustees.

III. In holding that the claims of the United States are not entitled to priority over the claims of preferred creditors.

IV. In holding that the claims of the United States are not entitled to priority over the claims of general creditors.

REASONS FOR GRANTING THE WRIT

I. This case raises a question which has not heretofore been decided by this Court, namely, whether the priority statute (R. S. Section 3466) applies to claims of the United States arising under the Transportation Act of 1920, and, if so, over what classes of claims such claims of the United States have priority. These are important questions of Federal law. A determination of these questions by

this Court is desirable, not only because of the large amount involved in the instant case, but also because over $50,000,000, owing the United States as a result of transactions pursuant to that Act, may later be involved in similar cases.

II. In so far as the decision of the Circuit Court of Appeals rests upon the theory that the claims arise from the engagement by the United States in a commercial and industrial venture, it is contrary to the decision of this Court in *United States* v. *Butterworth-Judson Corporation,* 269 U. S. 504.

III. The Circuit Court of Appeals has narrowly construed R. S. Section 3466 contrary to the long-established rule that this statute is to be liberally construed in favor of the United States, as laid down by this Court in *United States* v. *State Bank of North Carolina,* 6 Pet. 29, and recently reiterated in *Bramwell* v. *U. S. Fidelity Co.,* 269 U. S. 483, 487.

Wherefore, it is respectfully submitted that this petition should be granted.

CHARLES E. HUGHES, JR.,
Solicitor General.

SEPTEMBER, 1929.

BRIEF IN SUPPORT OF THE PETITION

OPINIONS BELOW

The District Court rendered no opinion, but adopted (R. 88) the memorandum of the Special Master, which is unreported, but appears in the Record at pages 20–82. The opinion of the Circuit Court of Appeals has not yet been reported but is printed in the Record at pages 110–118.

JURISDICTION

The decree of the Circuit Court of Appeals sought to be reversed was entered May 15, 1929. (R. 118.) An order extending the time for filing the petition for the writ to September 17, 1929, was entered by this Court on August 10, 1929. (R. 119.) Jurisdiction to issue the writ is invoked under the provisions of Section 240 (a) of the Judicial Code, as amended by the Act of February 13, 1925.

QUESTION PRESENTED

Whether, in the distribution of the assets of an insolvent railroad company in receivership, the United States is entitled under R. S. Section 3466 to priority over mortgagees, preferred creditors, and general unsecured creditors, or any of them, in payment of debts due it under the Transportation Act of 1920, Sections 207, 209, and 210.

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THE STATUTE

R. S. Section 3466 (U. S. C. Title 31, Sec. 191):

> Whenever any person indebted to the United States is insolvent, or whenever the estate of any deceased debtor, in the hands of the executors or administrators, is insufficient to pay all the debts due from the deceased, the debts due to the United States shall be first satisfied; and the priority hereby established shall extend as well to cases in which a debtor, not having sufficient property to pay all his debts, makes a voluntary assignment thereof, or in which the estate and effects of an absconding, concealed, or absent debtor are attached by process of law, as to cases in which an act of bankruptcy is committed.

STATEMENT

A statement of the facts and an assignment of the errors relied on are set forth in the petition, pp. 1–5, *supra.*

ARGUMENT

I

THE PRIORITY STATUTE, R. S. SECTION 3466, IS APPLICABLE TO THE CLAIMS OF THE UNITED STATES IN THE INSTANT CASE.

The cases in which the priority statute is applicable are enumerated in the latter part of R. S. Section 3466. Here the bill of complaint, praying for appointment of a receiver, alleged the insolvency of the Railroad Company. (R. 1.) The answer admitted its allegations and joined in the prayer that a receiver be appointed to take charge

and possession of its assets. (R. 2.) The assets of the corporation were accordingly turned over to a receiver, and it is now established that the corporation is insolvent within the meaning of R. S. Section 3466 and as defined by the Bankruptcy Act. (R. 18.) As this Court said in *United States* v. *Butterworth-Judson Corporation,* 269 U. S. 504, 513–514:

> Taken in connection with its insolvency, now conceded, respondent's answer admitting the allegations of the complaint and its consent to the decree appointing receivers amounted to the handing over of all its property and business to the receivers to be administered, under the direction of the court, as a trust fund to pay respondent's debts. In substance, the things done by respondent amounted to a voluntary assignment of all its property within the meaning of § 3466.

The Circuit Court of Appeals did not question this point, but in effect held that claims arising under the Transportation Act of 1920 were not "debts due to the United States" within the meaning of the first part of R. S. Section 3466. We submit that in this that court erred. As this Court has said in numerous cases, from 1832 in *United States* v. *State Bank of North Carolina,* 6 Pet. 29, 35, to 1925 in *Bramwell* v. *U. S. Fidelity Company,* 269 U. S. 483, 487, "As this statute has reference to the public good it ought to be liberally construed." In *Beaston* v. *Farmers' Bank,* 12 Pet. 102, 133, 134, the Court laid down the following rule concerning the

construction of the statute which is now Section 3466:

> * * * the person who becomes invested with the title, is thereby made a trustee for the United States, and is bound to pay their debt *first* out of the proceeds of the debtor's property. (Italics ours.)
>
> * * * * *
>
> All debtors to the United States, whatever their character, and by whatever mode bound, may be fairly included within the language used in the fifth section of the act of Congress. And it is manifest, that Congress intended to give priority of payment to the United States over all other creditors, in the cases stated therein. It, therefore, lies upon those who claim exemption from the operation of the statute, to show that they are not within its provisions.

That section extends to debtors generally and is not restricted to any particular class of debts. *Bramwell* v. *U. S. Fidelity Co.,* 269 U. S. 483, 487, *supra; United States* v. *Fisher,* 2 Cranch 358, 397.

The Circuit Court of Appeals, after discussing the Transportation Act of 1920, concluded that it should be accorded the same construction placed upon the Federal Control Act by this Court in *Mellon* v. *Michigan Trust Company,* 271 U. S. 236. But the opinion in that case expressly states at page 239 that "decision of this cause, therefore, must turn upon the effect to be given § 10, Act of 1918," quoted at page 238. That section provides that while under Federal control the carriers shall be

subject to all laws and liabilities to which common carriers are ordinarily subject, except in so far as may be inconsistent with that Act. The Transportation Act contains no such provision. Sections 207 and 210 (under which some of the claims arise) provide, as stated by the Circuit Court of Appeals, that the Government shall take security for loans made and money advanced to railroads pursuant to the provisions of that Act. But this is not inconsistent with the priority granted by Section 3466 because that priority attaches only in the events specified in the latter part of that section. In all other events the Government would have to rely upon an ordinary right of action or upon the security. We submit that the decision in *Mellon* v. *Michigan Trust Company, supra,* resting as it does squarely upon the provisions of Section 10 of the Federal Control Act, affords no support to the Circuit Court of Appeals' construction of the totally dissimilar language of the Transportation Act of 1920.

Moreover, the cash loan (Claim 2700, Item One) and the cash overpayment of the amount guaranteed the Railroad Company during Federal control (Claim 4186) are entirely different in character from the claims asserted in the *Michigan Trust Case,* which were transportation and freight charges accruing to the Director General as the operator of railroads. It must be remembered that these cash loans out of the Treasury of the United States were made long after the termination of Federal control and accrue to the United States—

not to the Director General as the operator of the railroads. They arise because of cash transactions directly between the United States and the Railroad Company and therefore are not to be classed with transportation and freight charges. Although we submit that Items Three and Four of Claim 2700 are also distinguishable from the type of indebtedness involved in the *Michigan Trust Case,* the distinction between these two debts and those involved in that case is not as broad as is the distinction between the loans and the freight charges, for although these items include expenditures by the United States as additions and betterments made to the carrier's property, they also include a variety of general accounts due the Government after final settlements were reached, the balance being funded pursuant to Section 207 of the Transportation Act by the execution of notes by the Railroad Company to the Director General.

The Circuit Court of Appeals concludes that the conditions surrounding the transactions in question differ in no substantial respect from those between private parties, and should be governed by no other rules. That the priority granted by Section 3466 may not be denied merely because the transaction giving rise to the debt has the appearance of a commercial transaction, is clear from the decision of this Court in *United States* v. *Butterworth-Judson Corporation,* 269 U. S. 504, holding that Section 3466 applied to a debt arising from a contract between the corporation and the Government whereby the former agreed to manufacture and sell

picric acid to the Government. The record (p. 10) before this Court in that case shows that the acid covered by the contract was for the use of the War Department during the World War. If that transaction was not commercial in character, then the transactions here are not, for, in both instances they took place because the Government had engaged in war.

II

THE CLAIMS OF THE UNITED STATES SHOULD HAVE PRIORITY OVER THE CLAIMS OF THE MORTGAGE TRUSTEES.

The language of Section 3466 makes no exception in favor of claims arising under mortgages, and this Court in cases quoted or referred to above has said that the priority of the United States "is over all other creditors."

The Circuit Court of Appeals cites several old cases in this Court and in the lower Federal courts as authority for its holding that the priority claim of the Government is inferior to the mortgage lien. (R. 114.) That court then goes on to say (R. 114):

> * * * The contention of the Government is that the doctrine announced by the decisions just cited, upon which appellees rely, was dictum merely, and, therefore, not entitled to weight as a determination by the Supreme Court; * * *.
>
> With respect to the first of these propositions it may be said that while, strictly speaking, the rule announced by the Su-

preme Court in a number of these cases may be regarded as dictum, nevertheless the reannouncement of the doctrine repeatedly over a period of more than a hundred years serves to establish it, not only as the consistent view of the court, but also as a rule of property upon which practical transactions have been, and are being, based.

The language in all of the cases relied upon apparently springs from the case of *United States* v. *Hooe,* 3 Cranch 73. But that case, we submit, does not *hold* that a mortgagee's rights defeat the priority of the United States. There the United States sued to set aside a deed of trust on the ground that it was fraudulent as to creditors generally and also on the ground that the United States had the right to priority in payment of its debts before the claims secured by the deed of trust could be satisfied out of the proceeds of the mortgaged property. At page 75 it appears that *the evidence did not establish Fitzgerald's* [*the debtor's*] *insolvency,* and this fact is clearly relied upon by the Court on page 90 of its decision. Before the priority granted by Section 3466 can attach, insolvency, manifested in one of the modes described in the statute, must be proved. At page 91, the Court explained that the priority statute applied only where a conveyance or assignment of the debtor's property included *all* his property, and it appeared clearly on page 89 that the deed of trust covered only a *part* of Fitzgerald's property. The priority of the United States did not prevail in that case because the facts before the

Court did not constitute a case within the letter or the intention of the priority statute. The decision would have been exactly the same had Hooe been a mere general creditor. We consequently submit that it is not authority for the proposition that claims of the United States have priority over debts secured by mortgage, although we realize that it has often been so regarded.

We contend that there is no practical necessity (such as the court below urges) for its construction of the priority statute. It can hardly be said that the parties involved in this case contemplated that such debts as the Government is here trying to collect should not be given priority over the mortgage claim. The fact, of course, is that when the mortgages were executed no one ever considered the possibility that the loans in question would be made. They were incidental to the unprecedented emergency caused by the war. If the Government had not taken the action which it did, it is highly likely that the assets of the railroad on which the mortgages give liens would have deteriorated tremendously in value. The action of the Government was undoubtedly exceedingly beneficial to the bondholders.

III

THE CLAIMS OF THE UNITED STATES SHOULD HAVE PRIORITY OVER THE CLAIMS OF PREFERRED CREDITORS

The courts below held that there are certain other preferred creditors. These are creditors whose claims arose as a current expense of ordinary oper-

ation of the railroad, which were necessary for the preservation of the road and to the business of the road, which were contracted with the expectation and intention of the parties that they were to be paid out of the current earnings of the road, and which accrued within six months prior to the appointment of the receiver. (R. 110.) It is, of course, settled that under certain circumstances such creditors have equitable liens upon certain assets of the estate. None of the cases cited in the opinion of the Circuit Court of Appeals (R. 117), however, raises or discusses the relative priority of such claims and claims of the United States, and we are not aware of any case in which this question has been raised.

The argument which we advance above in favor of priority of the claims of the United States over the claims of the mortgage trustees is equally applicable to these preferred claims.

IV

THE CLAIMS OF THE UNITED STATES SHOULD HAVE PRIORITY OVER THE CLAIMS OF GENERAL CREDITORS

The District Court allowed none of the claims of the United States a preferential status even as to general creditors. The Circuit Court of Appeals said (R. 118):

> Inasmuch as only holders of liens legal and equitable are before us on this appeal, and since it is conceded that the estate will not realize more than enough to discharge the mortgage indebtedness and preferred claims, we find it unnecessary to consider the

> effect of the decretal order upon general creditors. It follows from what has been said that the decree should be and is affirmed.

The Master said (R. 74):

> It is improbable that the property of the Minneapolis & St. Louis will sell at foreclosure sale for more than the amount of the mortgaged indebtedness with accrued interest.

The Government, however, has not conceded and does not concede that the estate will not realize more than enough to discharge the mortgage indebtedness and preferred claims. The property has not been sold, and in this situation the Government is not willing that the provisions of the decrees below shall stand. The Government asserted its claim to priority over all other creditors both in the District Court and in the Circuit Court of Appeals. (R. 88–89.) The denial of the Government's claim to priority over general unsecured creditors is contrary to the decisions of this Court in the recent cases of *Bramwell* v. *U. S. Fidelity Co.*, 269 U. S. 483, *supra*, and *United States* v. *Butterworth-Judson Corporation*, 269 U. S. 504, *supra*, unless the court below was right in construing the Transportation Act of 1920 as excluding claims arising under it from the operation of R. S. Section 3466.

CONCLUSION

Application of the priority statute in any case works a certain hardship upon private creditors. General principles of justice and equity obviously

can not control in construing and applying it, unless it is to be annulled by construction. Its harshness is not a matter for the courts, *St. Louis, I. M. & S. Ry. Co.* v. *Taylor,* 210 U. S. 281, 295, but is one of legislative policy, which was settled with the enactment of Section 3466.

The application of the priority statute to the claims of the United States in the instant case, however, can not be said to work a hardship upon the various classes of creditors, inasmuch as the loans and advances of the Government were of great benefit to the mortgage creditors, as has been pointed out above, and it is not reasonable to assume that any class of creditors contemplated that their claims would be preferred to such claims of the Government.

In view of the importance of the questions involved and of the fact that the decision below seems to be in conflict with the principles announced by this Court in the cases which have been cited, it is respectfully submitted that a writ of certiorari should be issued.

CHARLES E. HUGHES, JR.,
Solicitor General.

JOHN LORD O'BRIAN,
The Assistant to the Attorney General.

CLAUDE R. BRANCH,
ELMER B. COLLINS,
Special Assistants to the Attorney General.

SEPTEMBER, 1929.

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CHARLES ELMORE

No. 402

In the Supreme Court of the United States

OCTOBER TERM, 1929

THE UNITED STATES OF AMERICA, PETITIONER

v.

GUARANTY TRUST COMPANY OF NEW YORK ET AL.

ON WRIT OF CERTIORARI TO THE UNITED STATES CIRCUIT COURT OF APPEALS FOR THE EIGHTH CIRCUIT

BRIEF FOR THE UNITED STATES

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In the Supreme Court of the United States

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No. 402

THE UNITED STATES OF AMERICA, PETITIONER

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ON WRIT OF CERTIORARI TO THE UNITED STATES CIRCUIT COURT OF APPEALS FOR THE EIGHTH CIRCUIT

BRIEF FOR THE UNITED STATES

OPINIONS BELOW

The District Court filed a memorandum opinion (R. 72) adopting the conclusions reached in the report (R. 2) and attached memorandum (R. 17) of the Special Master. The opinion of the Circuit Court of Appeals for the Eighth Circuit (R. 81) is reported in 33 F. (2d) 533.

JURISDICTION

The decree of the Circuit Court of Appeals was entered May 15, 1929. (R. 91.) This Court on August 13, 1929, extended the time for filing petition for writ of certiorari to September 17, 1929.

(R. 93.) Petition for writ of certiorari was filed on that date and was allowed October 21, 1929. (R. 93.) The jurisdiction of the Court rests on Section 240 (a) of the Judicial Code as amended by the Act of February 13, 1925.

QUESTION PRESENTED

The question presented is whether under Revised Statutes, Section 3466, the indebtedness of an insolvent railroad to the United States which arose under Sections 207, 209, and 210 of the Transportation Act, 1920, is entitled to priority over amounts due prior mortgagees, unsecured preferred creditors, or unsecured general creditors.

STATUTES INVOLVED

R. S. Section 3466 (U. S. C. Title 31, Sec. 191) provides:

> Whenever any person indebted to the United States is insolvent, or whenever the estate of any deceased debtor, in the hands of the executors or administrators, is insufficient to pay all the debts due from the deceased, the debts due to the United States shall be first satisfied; and the priority hereby established shall extend as well to cases in which a debtor, not having sufficient property to pay all his debts, makes a voluntary assignment thereof, or in which the estate and effects of an absconding, concealed, or absent debtor are attached by process of law, as to cases in which an act of bankruptcy is committed.

Parts of Sections 207, 209, and 210 of the Transportation Act, 1920, c. 91, 41 Stat. 456, et seq., as amended, are set forth in the Appendix.

STATEMENT

On July 26, 1923, a receiver of The Minneapolis & St. Louis Railroad Company (hereinafter sometimes referred to as the Minneapolis Railroad) was appointed by the District Court of the United States for the District of Minnesota upon application contained in a creditor's bill alleging that the railroad was insolvent and unable to pay its debts. (R. 1, 81.) The railroad's answer, filed the same day, admitted the allegations of the bill and joined in the prayer for the appointment of a receiver. (R. 1.) Subsequently actions were instituted for the foreclosure of mortgages on the railroad's property and were consolidated with the suit instituted by the creditor's bill. (R. 81.) These mortgages were made at various dates between 1877 and 1912, inclusive (before the indebtedness to the United States was incurred), and are valid record liens upon the properties of the railroad. (R. 10–13.) In the receivership proceedings certain creditors claimed an equitable lien superior to all other demands on account of claims which arose within six months prior to the receivership as a current expense of ordinary operation and which were contracted with the expectation and intention that they should be paid out of current earnings. (R. 81, 86.)

The United States properly filed with the receiver claims for certain amounts due it on obli-

gations arising under the provisions of the Transportation Act, 1920, c. 91, 41 Stat. 456. It contended that R. S. Section 3466 gave these claims priority over all others. (R. 81.) The decree entered by the District Court and affirmed by the Circuit Court of Appeals determined that these claims of the United States, with interest on the funded obligations to the date of receivership, were general claims without any priority in relation to any other claim. (R. 69, 91.) The claims for which the United States asserted priority arose as follows:

Claim 2700. Item One

A mortgage for $1,382,000, previously executed by the Minneapolis Railroad, matured April 1, 1921. To meet this obligation the Secretary of the Treasury, pursuant to Section 210 of the Transportation Act, 41 Stat. 468, made a loan to the railroad evidenced by its ten-year promissory note dated April 1, 1921, for $1,382,000, secured by certain of its refunding and extension mortgage bonds. (R. 4, 82.) Section 210, as amended by Section 5 of the Act of June 5, 1920, c. 235, 41 Stat. 874, 946, authorized the Secretary of the Treasury to make a loan to a railroad for a period not exceeding fifteen years, but only if application therefor was made within two years after termination of Federal control and the Interstate Commerce Commission found that "the making, in whole or in part, of the proposed loan by the United States

* * * is necessary to enable the applicant properly to meet the transportation needs of the public."

Claim 2700. Item Three

This claim arose under Section 207 of the Transportation Act, 41 Stat. 462. That section provides that as soon as practicable after the termination of Federal control the President shall ascertain (1) the amount of the indebtedness of each railroad to the United States, which may exist at the termination of Federal control, incurred for additions and betterments made during Federal control and properly chargeable to capital account, (2) the amount of indebtedness of such railroad to the United States otherwise incurred, and (3) the amount of indebtedness of the United States to such railroad arising out of Federal control; that the amount under (3) may be set off against the amounts under (1) and (2); that any remaining indebtedness arising under (1) shall at the request of the railroad be funded for a period of ten years from the termination of Federal control, or at a shorter period at the option of the railroad; and that any other indebtedness to the United States after mutual settlement of accounts shall be evidenced by notes due in one year from termination of Federal control, or a shorter period at the option of the railroad. Pursuant to this section, the Minneapolis Railroad gave its promissory note for $625,000 dated May 27, 1922, and due ten years after termination of Federal control, secured by certain

of its refunding and extension mortgage bonds. (R. 7, 82.)

Claim 2700. Item Four

This claim is represented by a promissory note of the Minneapolis Railroad for $625,000 dated April 1, 1923, payable on demand and secured by certain of its refunding and extension mortgage bonds. The note was given pursuant to Section 207 to fund the railroad's indebtedness to the United States due at the termination of Federal control. (R. 7, 82.)

Claim 4186

This claim arose under Section 209 of the Transportation Act, 41 Stat. 464. By this section the United States guaranteed each railroad which accepted its provisions a certain minimum operating income during the six months following the termination of Federal control. Subdivision (h) of this section directed the Secretary of the Treasury, on request of a railroad and on certification by the Interstate Commerce Commission, to advance during the six months' guaranty period such sums, not in excess of the estimated guaranty "as are necessary to enable it to meet its fixed charges and operating expenses." The railroad was also required to contract to repay any such excess advances. Subdivision (g) of this section provides that the Commission shall, as soon as practicable after the expiration of the guaranty period, certify to the Secretary of the Treasury the amounts necessary to make good the guaranty and the Secretary of

the Treasury is directed to pay the amount so certified.

The Interstate Commerce Commission determined that the amounts paid the Minneapolis Railroad under subdivisions (g) and (h) were $292,022.23 in excess of the amount payable to it by the United States under Section 209 and this determination is the basis of Claim 4186. (R. 9–10, 82.) The amount of this overpayment is disputed by the railroad and its receiver, and the decree of the District Court determined only the preferential status of the claim. (R. 10, 70.)

SPECIFICATION OF ERRORS TO BE URGED

The Circuit Court of Appeals erred:

(1) In holding that R. S. Section 3466 does not apply to claims of the United States arising under the Transportation Act, 1920.

(2) In holding that the claims of the United States are not entitled to priority over claims of mortgagees of the Minneapolis Railroad.

(3) In holding that the claims of the United States are not entitled to priority over claims of the railroad's unsecured preferred creditors.

(4) In holding that the claims of the United States are not entitled to priority over claims of the railroad's unsecured general creditors.

SUMMARY OF ARGUMENT

I. Claims of the United States on account of advances and credits to railroads under the Transpor-

tation Act, 1920, are within the express terms of R. S. Section 3466. The Government finds nothing in the Transportation Act which would warrant an inference that Congress intended to except claims arising thereunder from the priority rights given the United States by this section. The Act indicates that the advances and credits to railroads which it authorized the United States to grant were intended to establish the ordinary relationship of debtor and creditor. The decision in *Mellon* v. *Michigan Trust Company,* 271 U. S. 236, is not applicable. That case held that under the Federal Control Act certain claims of the Director General of Railroads arising against third persons in the ordinary course of railroad operation are not entitled to the benefits of this section. The decision turns upon special statutory limitations upon the assertion of Federal rights which are not found in the credit provisions of the Transportation Act.

II. While the courts have frequently expressed the view that under Section 3466 a claim supported by a specific lien on the debtor's property is prior to debts to the United States, it does not clearly appear that the question has been presented to this Court in any case in which it was necessary to the decision. The Government contends that the mortgagees' claims are subject to ~~the~~ general priority granted the United States by the section, and that this construction of the statute is not inequitable.

III. This Court has held that a general lien does not defeat the priority of the United States under

Section 3466. *Spokane County* v. *United States,* 279 U. S. 80. The creditors of the Minneapolis Railroad who claim an equitable lien have only a general or inchoate lien which must yield to the priority of the United States.

IV. The question of the priority of the United States over general unsecured creditors is not moot. The United States does not concede that the claims of the mortgagees and preferred creditors of the Minneapolis Railroad will absorb the entire amount realized on the sale of its property.

ARGUMENT

I

REVISED STATUTES, SECTION 3466, APPLIES TO CLAIMS OF THE UNITED STATES WHICH AROSE UNDER THE TRANSPORTATION ACT, 1920

The claims of the United States are governed by Section 3466 if that section applies to claims arising under the Transportation Act. This was the view of the Circuit Court of Appeals and has not been disputed. The section applies where a debtor is insolvent and makes a voluntary assignment of all his property. The insolvency of the Minneapolis Railroad within the meaning of the statute is conceded. See *United States* v. *Butterworth-Judson Corporation,* 269 U. S. 504, 513–514. It was alleged in the creditor's bill and admitted in the railroad's answer thereto. The exception taken to the Master's finding of insolvency was withdrawn upon the hearing in the District Court.

(R. 17, 69.) It is equally clear that the consent given by the Minneapolis Railroad to the appointment of a receiver was a voluntary assignment of all its property within the meaning of Section 3466. *Price* v. *United States,* 269 U. S. 492; *United States* v. *Butterworth-Judson Corporation,* 269 U. S. 504, *supra.*

We submit that claims arising under the Transportation Act are debts to the United States and within the express provisions of Section 3466, but the Circuit Court of Appeals, relying on *Mellon* v. *Michigan Trust Company,* 271 U. S. 236, held that Congress by the Transportation Act intended to except claims arising thereunder from the benefits of this section.

That case involved the question whether Section 3466 applied to claims of the Director General of Railroads for transportation charges and for conversion of a shipment of iron ore arising while he was operating a railroad under the Federal Control Act, c. 25, 40 Stat. 451. That Act was passed to govern Federal operation of carriers which the President had taken over under his war powers. Section 10 subjected the Director General, as an operator of the railroads, to the laws and liabilities previously applicable to them as common carriers except in so far as inconsistent with that Act or any other Act applicable to Federal control or with any order of the President. It provided that suits might be brought by and against carriers and judgments rendered "as now provided by law" and that

in such suit no defense should be made "upon the ground that the carrier is an instrumentality or agency of the Federal Government." This Court held that Section 10, read in the light of all the provisions of the Act, manifested the intention that Federal control should make no change in the status of claims against third persons arising in the ordinary course of railroad operations and that such claims were not intended to be accorded the preferences of Section 3466. It said (p. 240):

> In the circumstances presented by this record, it is reasonable to say that the statute confined his substantive rights to those which a carrier would have had, and prohibits him, as though he were an actual defendant in a suit, from resisting the demands of others for equal distribution of the insolvent's assets, under the commonly-applied rule, upon the ground that he is an instrumentality of the federal government.

The Government submits that none of the provisions of the Transportation Act dealing with credits and advances are analogous to Section 10 of the Federal Control Act and that nothing in the purpose or policy of the Act indicates an intention to change any of the statutory rights of the United States as a creditor.

The Transportation Act of 1920 is a comprehensive statute dealing with many aspects of the railroad problem. It terminated Federal control, it established procedure for adjusting labor disputes,

it enlarged the powers of the Interstate Commerce Commission. The provisions of the Act here in question provided for advances and credits to the railroads by the United States. The Act does not, as did the Federal Control Act, relate to rights or liabilities having their inception in the temporary conduct of a business enterprise by the Government.

The credits to railroads authorized by the Transportation Act represent special and temporary aid to be given them in the period of readjustment following the return of their properties. The Government was not engaging in the business of making loans. The period of credit was in all cases strictly limited. The credit permitted was for the benefit of the railroads. The taking of credits or advances was optional with the railroads. But the United States was not making gifts to the railroads or their creditors. The relationship between the Government and the railroad established by the credit provisions of the Act was strictly that of creditor and debtor. Credits and advances were to bear interest at 6%, security was provided for and new loans were to be made only upon reasonable assurance of repayment. Section 210, dealing with new loans, requires a statement of—

> the present and prospective ability of the applicant to repay the loan and meet the requirements of its obligations in that regard; the character and value of the security offered * * *.

It permits the loan only if the Interstate Commerce Commission finds—

> that the prospective earning power of the applicant and the character and value of the security offered are such as to furnish reasonable assurance of the applicant's ability to repay the loan within the time fixed therefor, and to meet its other obligations in connection with such loan * * *.

Subdivisions (b) and (d) of Section 207, dealing with indebtedness to the United States incurred during Federal control, provide for funding upon such security as the President may prescribe or require.

In *Piedmont Corporation* v. *Gainesville & N. W. R. Co.*, 30 F. (2d) 525, the United States District Court for the Northern District of Georgia held that Section 3466 applied to advances made by the United States under Section 210 of the Transportation Act.

II

UNDER SECTION 3466 THE CLAIMS OF THE UNITED STATES SHOULD HAVE PRIORITY OVER CLAIMS OF MORTGAGEES OF THE MINNEAPOLIS RAILROAD

The Government concedes that a large body of judicial opinion supports the view that the priority of the United States under Section 3466 is subject to the claim of any creditor who holds a specific lien on the debtor's property. The weight that should be accorded these cases is fully recognized. The Circuit Court of Appeals, without deciding whether

this Court had directly determined the question, said that the reannouncement of the doctrine over a period of more than one hundred years established it as the consistent view of this Court.

The Government requests a reconsideration of the question in this case because of its great importance and because it appears doubtful whether it ever has been directly presented to this Court in any case where it was necessary to a decision. It believes that the priority for which it contends is not inequitable in the present case and would not as a general rule prove inequitable.

The wording of this section appears to support the Government's claim. The priority given the United States is broadly stated—"debts due to the United States shall be first satisfied." The language makes no exception in favor of mortgagees. In *Beaston* v. *Farmers' Bank,* 12 Pet. 102, 134, the Court said:

> And it is manifest, that congress intended to give priority of payment to the United States over all other creditors, in the cases stated therein. It, therefore, lies upon those who claim exemption from the operation of the statute, to show that they are not within its provisions.

The section is to be liberally construed. In the case last cited the Court said (p. 134):

> As this statute has reference to the public good, it ought to be liberally construed.

In *Bramwell* v. *United States Fidelity Company*, 269 U. S. 483, the Court said (p. 487):

> There exists now the same reasons for a liberal construction of the priority act as when the rule was laid down.

It has been held that the priority given by this section overrides a prior general lien created by State law. *Spokane County* v. *United States*, 279 U. S. 80, *supra*. This decision is especially significant because the claims superseded were county taxes and it consequently involved the question of infringing on the rights of a sovereign State.

Certain cases have suggested that property subject to a specific lien is not a part of the debtor's estate until the debt secured thereby has been satisfied. We nevertheless submit that the extent to which the priority statute goes is a question of the intent of Congress. If, as this Court held in *Spokane County* v. *United States*, 279 U. S. 80, *supra*, under Section 3466 claims of the United States displace claims of a creditor holding a prior general lien on the debtor's property, there seems to be no logical reason why claims of the United States should not outrank those of a creditor secured by a specific lien.

The Government's principal claim against the Minneapolis Railroad represents an advance of $1,382,000 which it made in 1921 for the purpose of meeting a mortgage in the same amount maturing in that year, which was a first lien on part of the

road. (R. 20.) This advance was made at a time of great credit stringency. The Transportation Act permitted an advance only if it was found to be necessary to enable the railroad to meet the transportation needs of the public. Furthermore, the Minneapolis Railroad had received from the United States in 1920 current advances during the six months' guaranty period following the termination of Federal control, which were authorized by the Transportation Act only if necessary to enable it to meet its fixed charges and operating expenses. (*Supra,* pp. 6–7.) It can hardly be said that the parties involved in this case contemplated that such debts as the Government is here trying to collect should not be given priority over the mortgage claim. The fact, of course, is that when the mortgages were executed no one ever considered the possibility that the loans in question would be made. They were incidental to the unprecedented emergency caused by the war. If the Government had not taken the action which it did, it is highly likely that the assets of the railroad on which the mortgages give liens would have deteriorated tremendously in value. The action of the Government was undoubtedly beneficial to the bondholders.

The mortgagees have relied upon *United States* v. *Hooe,* 3 Cranch 73; *Conard* v. *Atlantic Insurance Co.,* 1 Pet. 386; *Field* v. *United States,* 9 Pet. 182; and *Brent* v. *The Bank of Washington,* 10 Pet. 596, as adjudications by this Court that

the lien of prior mortgagees is under Section 3466 superior to the claims of the United States.

In *United States* v. *Hooe* a collector of customs, who was indebted to the United States, made a deed of trust to Hooe to indemnify him against liability as surety on the debtor's official bond and against liability to be assumed as endorser of the debtor's notes. The debtor having died, the United States claimed priority as against Hooe. The Court stated the issues relating to the priority statutes as follows (p. 90):

> This claim is opposed on two grounds. It is contended, 1st. That at the time of making this deed, Fitzgerald was not insolvent in point of fact; and 2d. That this deed was not a transaction which evidences insolvency under the act of congress.

The Court squarely decided the case on the second ground stated above. The opinion of the Court and the argument of Government counsel as reported show that the United States based its claim for priority solely upon the theory that the deed of trust constituted a voluntary assignment of the debtor's property within the meaning of the statute. We submit that this was the only question upon which the Court passed, although it did use language which has often been regarded as indicating that it felt that the statute did not give the United States priority over debts secured by mortgage.

In *Conard* v. *Atlantic Insurance Co.*, 1 Pet. 386, after a judgment for the United States, the marshal levied upon certain goods as the property

of the judgment debtor. The insurance company, contending that title to the goods had previously passed to it under a *respondentia* bond and accompanying bills of lading, brought an action of trespass against the marshal and recovered. This Court affirmed the judgment on the ground that the priority statute gave the United States no title to the property of an insolvent debtor and that the insurance company had title at the time of the levy. The decision did not turn upon the relative priority of the United States and mortgagees. The Court said (p. 442):

> In none of these cases, has it ever been decided, that in a conflict of satisfaction out of the thing itself, the priority of the United States cut out the lien of the particular creditor. And before such decision is made, it will deserve very grave deliberation, and a marked attention to what fell from the court, in *Nathan* v. *Giles,* 5 Taunt. 558, 574. At present, it is wholly unnecessary to decide it, for reasons which will hereafter appear.

Field v. *United States,* 9 Pet. 182, was a suit brought by the United States against the assignees of an insolvent debtor for refusing to pay a claim of the United States. The defense to the action was that other creditors had a privilege on the fund under the laws of the State and that the claim of the United States was not included in the schedule of distribution affirmed by the State court. The lower court entered judgment for the United States for $5,661.55 and interest. This Court approved the

opinion of the lower court on the issues thus presented but pointed out that, although the assignees had sold the debtor's property for $13,000 more than the amount of his mortgage debts, nearly $25,000 of the sales price was represented by promissory notes and that it did not judicially appear that these notes had been paid. It sent the case back to the lower court for further proceedings on the theory that the claim of the United States was payable only out of funds available after satisfying the liens of mortgagees.

With a fund more than twice the amount of the claim of the United States apparently available to satisfy its judgment, it is improbable that the Government presented to the Court any claim for priority over the mortgagees.

In *Brent* v. *The Bank of Washington,* 10 Pet. 596, a decedent owned at the time of his death certain shares of stock in a bank located in the District of Columbia. The bank's charter provided that its stock could not be transferred without its consent, if the stockholder was indebted to the bank. The decedent died indebted to the bank and to the United States. Suit was brought by the executors for the use of the United States to compel the bank to transfer the stock. The bank defended on the ground that its claims had not been paid. One of the bank's contentions, stated in the report of the case at page 603, is:

> That even if the United States have a priority of payment, by the act of 1799 the char-

ter of the bank affects it; there being in the charter no exception in favor of the United States.

The Court held that the rights given by the bank's charter furnished a complete answer to a suit at law by the executors against the bank for not permitting a transfer; that the same objection was fatal to a suit at law in their name for the use of the United States; and that there was no reason for equity to act since the bank lent its money in good faith. Although the opinion discusses the priority statute, it does not clearly appear that the views expressed were considered a necessary part of the decision, except to the extent of holding that the priority statute does not give the United States such a lien on the debtor's property as will prevent a valid transfer of legal title after the indebtedness to the United States arose.

III

UNDER SECTION 3466 THE CLAIMS OF THE UNITED STATES SHOULD HAVE PRIORITY OVER CLAIMS OF THE RAILROAD'S UNSECURED PREFERRED CREDITORS

All of the reasons advanced for holding the priority granted in Section 3466 applicable to mortgagees apply with equal or greater force to the six-months' claimants.

Claims arising within six months of a receivership as a current expense of ordinary operation and contracted with the intention that they be paid out of current earnings may under some circumstances be enforced in equity and thus be regarded as in

the nature of equitable liens. *Fosdick* v. *Schall*, 99 U. S. 235; *Burnham* v. *Bowen*, 111 U. S. 776.

If the priority given by Section 3466 defeats even a statutory general or inchoate lien, it must likewise defeat a general equitable lien.

Spokane County v. *United States*, 279 U. S. 80, *supra*, held that the priority of the United States displaced a general lien for taxes given by State law. The Court said (p. 95):

> Whatever might have been the effect of more completed procedure in the perfecting of the liens under the law of the State, upon the priority of the United States herein, the attitude of the state court relieves us of consideration of it.

In *Thelusson* v. *Smith*, 2 Wheat. 396, this Court said (p. 426):

> A judgment gives to the judgment creditor a lien on the debtor's lands, and a preference over all subsequent judgment creditors. But the act of congress defeats this preference in favor of the United States, in the cases specified in the 65th section of the act of 1799.

Piedmont Corporation v. *Gainesville & N. W. R. Co.*, 30 F. (2d) 525, *supra*, held that a lien for wages and supplies given by a State law, which lien applies generally to all the property of the railroad, must yield to the priority of the United States under Section 3466.

The Circuit Court of Appeals suggested that it was illogical to hold that the mortgagees came ahead of the United States and the United States ahead of creditors having an equitable lien, while the latter might be preferred in equity to the mortgagees. The Government submits that such a result is not illogical. The mortgagees, who have asked the aid of a court of equity, should be compelled to do equity. As the United States is relying on a legal right created by statute and is demanding no equitable relief, it can not be subjected to the requirements of equitable relief as a condition to having its statutory right recognized. This would seem to follow from a *dictum* in *Fosdick* v. *Schall,* 99 U. S. 235, 253, *supra,* to the effect that if a mortgagee elects to pursue a strict foreclosure, he can not be compelled to do equity. If this Court holds in this case that the mortgage liens are prior to the claims of the United States under Section 3466, we submit that a fund equal to the amount of the mortgage claims should be set aside out of which both the six-months' claimants and mortgagees should be paid according to their respective priorities, as determined by the court, and that out of all assets then remaining the claims of the United States should be paid ahead of all other claims, even if this results in leaving part of the claims of the mortgagees unpaid.

IV

UNDER SECTION 3466 THE CLAIMS OF THE UNITED STATES SHOULD HAVE PRIORITY OVER CLAIMS OF THE RAILROAD'S UNSECURED GENERAL CREDITORS

If Section 3466 applies to the claims of the United States, they are prior to the general unsecured claims.

The decree of the District Court which the Court of Appeals affirmed gave the United States no priority over general creditors, and if Section 3466 is applicable, the decree must be modified.

The only remaining question is whether this is a moot issue in the case. The Circuit Court of Appeals stated that "it is conceded that the estate will not realize more than enough to discharge the mortgage indebtedness and preferred claims." (R. 90.) The United States makes no such concession, as it is impossible to predict in advance the amount for which the railroad property may be sold. The issue therefore is not moot. The United States asserted its claim to priority over all other creditors in the courts below (R. 72) and in the petition for certiorari specifically assigned as error the holding that its claims are not entitled to priority over the claims of general creditors.

CONCLUSION

We submit that the decrees of the Circuit Court of Appeals and of the District Court should be reversed with directions to enter a decree which will give the claims of the United States arising under Sections 207, 209, and 210 of the Transportation Act priority over all other claims.

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DECEMBER, 1929.

APPENDIX

Transportation Act, 1920, c. 91, 41 Stat. 456, 462–466, as amended by Act of June 5, 1920, c. 235, 41 Stat. 874, 946:

SEC. 207. (a) As soon as practicable after the termination of Federal control the President shall ascertain (1) the amount of the indebtedness of each carrier to the United States, which may exist at the termination of Federal control, incurred for additions and betterments made during Federal control and properly chargeable to capital account; (2) the amount of indebtedness of such carrier to the United States otherwise incurred; and (3) the amount of the indebtedness of the United States to such carrier arising out of Federal control. The amount under clause (3) may be set off against either or both of the amounts under clauses (1) and (2), so far as deemed wise by the President * * *.

(b) Any remaining indebtedness of the carrier to the United States in respect to such additions and betterments shall, at the request of the carrier, be funded for a period of ten years from the termination of Federal control, or a shorter period at the option of the carrier, with interest at the rate of 6 per centum per annum, payable semiannually, subject to the right of such carrier to pay,

on any interest-payment day, the whole or any part of such indebtedness. Any carrier obtaining the funding of such indebtedness as aforesaid shall give, in the discretion of the President, such security, in such form and upon such terms, as he may prescribe.

* * * * *

(d) Any other indebtedness of any such such carrier to the United States which may exist after the settlement of accounts between the United States and the carrier and is then due shall be evidenced by notes payable in one year from the termination of Federal control, or a shorter period at the option of the carrier, with interest at the rate of 6 per centum per annum, and secured by such collateral security as the President may deem it advisable to require.

SEC. 209. (a) When used in this section—

* * * * *

The term "guaranty period" means the six months beginning March 1, 1920.

* * * * *

(c) The United States hereby guarantees—

(1) With respect to any carrier with which a contract (exclusive of so-called cooperative contracts or waivers) has been made fixing the amount of just compensation under the Federal Control Act, that the railway operating income of such carrier for the guaranty period as a whole shall not be less than one-half the amount named in such contract as annual compensation, or, where the contract fixed a lump sum as compensation

for the whole period of Federal operation, that the railway operating income of such carrier for the guaranty period as a whole shall not be less than an amount which shall bear the same proportion to the lump sum so fixed as six months bears to the number of months during which such carrier was under Federal operation, including in both cases the increases in such compensation provided for in section 4 of the Federal Control Act;

* * * * *

(g) The Commission shall, as soon as practicable after the expiration of the guaranty period, ascertain and certify to the Secretary of the Treasury the several amounts necessary to make good the foregoing guaranty to each carrier. The Secretary of the Treasury is hereby authorized and directed thereupon to draw warrants in favor of each such carrier upon the Treasury of the United States, for the amount shown in such certificate as necessary to make good such guaranty. An amount sufficient to pay such warrants is hereby appropriated out of any money in the Treasury not otherwise appropriated.

(h) Upon application of any carrier to the Commission, asking that during the guaranty period there may be advanced to it from time to time such sums, not in excess of the estimated amount necessary to make good the guaranty, as are necessary to enable it to meet its fixed charges and operating expenses, the Commission may certify to the Secretary of the Treasury the amount of, and times at which, such advances, if any,

shall be made. The Secretary of the Treasury, on receipt of such certificate, is authorized and directed to make the advances in the amounts and at the times specified in the certificate, upon the execution by the carrier of a contract, secured in such manner as the Secretary may determine, that upon final determination of the amount of the guaranty provided for by this section such carrier will repay to the United States any amounts which it has received from such advances in excess of the guaranty, with interest at the rate of 6 per centum per annum from the time such excess was paid. There is hereby appropriated, out of any money in the Treasury not otherwise appropriated, a sum sufficient to enable the Secretary of the Treasury to make the advances referred to in this subdivision.

SEC. 210. (a) For the purpose of enabling carriers by railroad subject to the Interstate Commerce Act properly to serve the public during the transition period immediately following the termination of Federal control, any such carrier may, at any time after the passage of this Act, and before the expiration of two years after the termination of Federal control make application to the commission for a loan from the United States to meet its maturing indebtedness, or to provide itself with equipment or other additions and betterments, setting forth the amount of the loan; the term for which it is desired; the purpose of the loan and the use to which it will be applied; the present and prospective ability of the applicant to repay the loan and

meet the requirements of its obligations in that regard; the character and value of the security offered; and the extent to which the public convenience and necessity will be served. The application shall be accompanied by statements showing such facts in detail as the commission may require with respect to the physical situation, ownership, capitalization, indebtedness, contract obligations, operation, and earning power of the applicant, together with such other facts relating to the propriety and expediency of granting the loan applied for, and the ability of the applicant to make good the obligation as the commission may deem pertinent to the inquiry.

(b) If the commission, after such hearing and investigation, with or without notice, as it may direct, finds that the making, in whole or in part, of the proposed loan by the United States, for one or more of the aforesaid purposes, is necessary to enable the applicant properly to meet the transportation needs of the public, and that the prospective earning power of the applicant and the character and value of the security offered are such as to furnish reasonable assurance of the applicant's ability to repay the loan within the time fixed therefor, and to meet its other obligations in connection with such loan the commission shall certify to the Secretary of the Treasury its findings of such facts; also the amount of the loan which is to be made; the time, not exceeding fifteen years from the making thereof, within which

it is to be repaid; the terms and conditions of the loan, including the security to be given for repayment; that the prospective earning power of the applicant, together with the character and value of the security offered, furnish, in the opinion of the commission, reasonable assurance of the applicant's ability to repay the loan within the time fixed therefor and reasonable protection to the United States; and that the applicant, in the opinion of the commission, is unable to provide itself with the funds necessary for the aforesaid purposes from other sources.

(c) Upon receipt of such certificate from the commission the Secretary of the Treasury shall immediately, or as soon as practicable, make a loan of the amount recommended in such certificate out of any funds in the revolving fund provided for in this section and accept the security prescribed therefor by the commission. All such loans shall bear interest at the rate of 6 per centum per annum, payable semiannually, to the Secretary of the Treasury, and to be placed to the credit of said revolving fund. The form of obligation to be entered into shall be prescribed by the Secretary of the Treasury, but the time, not exceeding fifteen years from the making thereof, within which such loan is to be repaid, the security which is to be taken therefor, and the terms and the conditions of the loan shall be in accordance with the findings and the certificate of the commission.

* * * * *

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Supreme Court of the United States

OCTOBER TERM, 1929.

No. 402.

UNITED STATES OF AMERICA,
Petitioner,

vs.

GUARANTY TRUST COMPANY OF NEW YORK, *et al.*,
Respondents.

MOTION OF RESPONDENTS TO ADVANCE.

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Supreme Court of the United States,

OCTOBER TERM, 1929.

UNITED STATES OF AMERICA, Petitioner, vs. GUARANTY TRUST COMPANY OF NEW YORK, *et al.*, Respondents.	No. 402.

MOTION OF RESPONDENTS TO ADVANCE.

Come the respondents in the above entitled cause and move that this case be advanced for an early hearing and in support of their motion make the following brief statement of the matter involved and the reasons relied upon for the advancement.

The question involved in the above case is whether the United States is entitled under Section 3466 R. S. to priority in payment of debts due it over other creditors; namely, (1) mortgage trustees, (2) preferred creditors, and (3) general unsecured creditors, or any of them. Such question grows out of the receivership of the Minneapolis & St. Louis Railroad Company which owns 1,500 miles of lines situated in four States. The Receiver was appointed in the creditors' cause in July of 1923. Six of the seven mortgages of the System are now in foreclosure.

A decree of foreclosure and sale was entered nearly a year ago in January, 1929. In view of the fact that the receivership presented many complicated legal questions as to equipment and property liens, elaborate proofs were necessary.

Only through the cooperation of the courts below and the special efforts of counsel was it possible to have the appeals from the foreclosure decree argued before the Circuit Court of Appeals of the Eighth Circuit in June of this year. 4,500 claims and demands against the carrier were filed with the Master. All but eight or ten of these claims have been heard and a large number have been determined as entitled to a preference in payment. The Master's report as to prereceivership diversions was argued before the Circuit Court of Appeals in January, 1929. It is believed that final determination of the questions as to equipment and property liens, prereceivership diversions and the extent of the Government's priority will leave the way open for a reorganization of this property. A decision on the first two points is expected in the near future.

Until the approximate amount of cash necessary to pay claims found to be entitled to payment in priority to the mortgage debts is determined, it is impossible for the security holders or the Committees representing them to promulgate a reorganization plan.

The courts below and counsel representing many interests have since the entry of the decree of foreclosure and sale cooperated to the utmost in expediting the determination of the questions including the ones presented by this case in order that a sale of the property and the lifting of the receivership might not be further delayed. These efforts will have been made in vain unless this motion is granted. Such efforts have been made in the belief that the public interest required this receivership be ended as soon as it is practicable to do so. Respondents believe that it is not only in the public interest but in the interest of the many creditors and others affected by this case that this motion should be granted.

All of the respondents including the Receiver acting pursuant to the instructions of Circuit Judge Wilbur F. Booth, who has been in charge of the receivership since its inception, have joined in this motion.

WHEREFORE the respondents pray that the case be advanced upon the calendar and assigned for hearing at an early date.

Respectfully submitted,

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Supreme Court of the United States

October Term 1929.

No. 402.

UNITED STATES OF AMERICA,

Petitioner,

vs.

GUARANTY TRUST COMPANY OF NEW YORK, et al.,

Respondents.

JOINT BRIEF OF MORTGAGE TRUSTEES AND PREFERRED CREDITORS OPPOSING PETITION FOR WRIT OF CERTIORARI.

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Supreme Court of the United States

October Term 1929.

No. 402.

UNITED STATES OF AMERICA,

Petitioner,

vs.

GUARANTY TRUST COMPANY OF NEW YORK, et al.,

Respondents.

JOINT BRIEF OF MORTGAGE TRUSTEES AND PREFERRED CREDITORS OPPOSING PETITION FOR WRIT OF CERTIORARI.

This case presents several questions, namely, whether in the distribution of the assets of an insolvent railroad company in receivership the United States is entitled under Section 3466 R. S. to priority in payment of debts due it from that company over indebtedness due (1) bondholders secured by prior recorded mortgages; (2) preferred creditors, (3) general creditors.

Although the questions as to the relative priority of the United States and each of the classes named are separate and distinct questions, this brief is filed jointly by the mortgage trustees and the preferred creditors.

The rules governing applications for certiorari have been stated in so many instances as to require neither repetition or citation of the cases. It has never been suggested that in the application of these rules, the Government stands in any different position from that of any other suitor before the Court.

Nothing more than the most casual reference to the issues in the instant case is required to demonstrate that the pending application is without merit and that the questions sought to be urged on the Court's consideration are largely of moot significance. The determinative principles of law involved have, for the most part, been settled by an unbroken line of decisions by this and the inferior courts of the United States extending back over a century.

The circumstance that collateral issues are suggested (though in no wise necessary to the determination of the case), the decision of which might prove of advantage in other prospective litigation, is of no materiality. It is a novel concept that recourse to certiorari may be had with the objective purpose of eliciting advisory opinions from the Court.

In the present case, the facts, summarized, disclose that the Minneapolis & St. Louis Railroad Company was placed in the hands of a receiver by the United States District Court of Minnesota in July, 1923. The original suit was instituted by unsecured creditors. At the time the receiver was appointed, the property of the defendant railroad was encumbered by a series of mortgages, the validity of which is undisputed. All of these mortgages, with the liens consequent thereon, long ante-dated the claims of the Government. Foreclosure pro-

ceedings were subsequently instituted with the usual orders extending the previous receivership and consolidating the causes.

In the regular course of these proceedings, the Government filed a series of claims arising upon obligations of the defendant railroad created under the Federal Control and Transportation Acts. The character of these claims is sufficiently set forth in the report of the Master (Rec. pp. 3 et. seq.) and the opinion of the Circuit Court of Appeals (Rec. pp. 110-111).

The Government asserted a preferential right with respect to the payment of these claims, both as against the mortgagees and all other creditors of the defendant railroad by virtue of Section 3466 of the Revised Statutes.

The right thus asserted was denied by the Master in a report and opinion of scholarly and exhaustive character in which the authorities were fully reviewed (Rec. pp. 3 et. seq.).

On exceptions to the Master's report, it was approved by Circuit Judge Booth, acting by assignment as District Judge (Rec. p. 88).

On appeal to the Circuit Court of Appeals of the Eighth Circuit, the Order and Decree of the lower Court was affirmed (Rec. p. 118).

It may be noted in passing that, as far as the tribunals below are concerned, there was no diversity or conflict with respect to the controlling principles. Each of the opinions rendered attested the significant circumstance, that those principles had been settled by the uniform course of decision in this and the lower Federal Courts almost from the date of the enactment of the statute under which the Government's claim of priority was made. Notwithstanding, the Government by the present application, is, in effect, seeking the review and reversal of principles as old as the law itself.

To demonstrate how devoid of significance the matters now presented by the Government really are, it is essential to broadly state what is necessarily inherent in its claims. This will serve the dual purpose of disclosing what are to be considered as the moot character of the issues as well as their severable character.

In asserting its claims of preference, the Government necessarily asserts preference in the following respects, viz:

First: Over the mortgages, the liens whereof had existed long previously to the time the Government's claims were created and in consequence, to the time when the preferential right could be asserted;

Second: Over the preferred creditors whose rights, if any, proceed from a conception of equitable liens, *having priority to the mortgages,* and the rights with respect to which were vested before the appointment of the receiver and thus before any right on the part of the Government to assert a preference, arose;

Third: Over the general creditors,—a right which could only exist in respect to the administration and distribution of the proceeds of unmortgaged assets.

That the claims thus asserted are independent and their determination may proceed from wholly independent principles is obvious. In considering the pending application, the severability of the questions thus suggested should not be overlooked. They may be briefly mentioned in the order stated.

I.

As to the Mortgage Bondholders.

This question has been decided by this Court, which has definitely held that the priority of the United States, under the statute, whenever it exists, is postponed to prior liens, including liens by mortgages.

United States v. Hooe, 3 Cranch 73 (1805).
Conard v. Atlantic Insurance Co., 1 Peters 386 (1828).
Field v. United States, 9 Peters 182 (1835).
Brent v. Bank of Washington, 10 Peters 596 (1836).

It is argued that while the Court has so stated the law, analysis of its decisions shows that support for the rule is found in dictum rather than in holding of the Court, and that the decisions in question were written when the common law theory prevailed—that a mortgage was a conveyance of title, eliminating the mortgaged property from the estate of the mortgagor,—thereby furnishing support for the asserted dictum, which theory has been abrogated in favor of the lien theory of mortgages. The rule, however, does not rest upon dictum, however well considered. *United States v. Hooe* necessarily decides that on insolvency and death the Government's priority does not over-ride a prior mortgage. *Conard v. Atlantic Insurance Company* decides that it does not override a maritime lien by respondentia. *Brent v. Bank of Washington* decides that it does not override a lien created by the by-laws of the Bank. There is no difference in substance between such liens and the legal liens of mortgages. It is true that a mortgage is no longer commonly regarded as a conveyance of property but neither is a respondentia and certainly a bank's lien on its own shares is not and never was such a conveyance.

The substance of the priority statute (Section 3466 R. S.) has been in force since 1797 (1 Stat. at Large, 515). For nearly one hundred and twenty-five years it has been the understanding of the Courts and of the Bar that the priority of the United States under it is subordinated to prior liens. This is demonstrated by numerous decisions (other than those above cited) as well as by various dicta of the Courts.

Savings & Loan Society v. Multnomah County, 169 U. S. 421, 428.

Cottrell v. Pierson, 12 Fed. 805.

United States v. Duncan, Fed. Cases 15,003, p. 935.

United States v. Lewis, Fed. Cases 15,595, p. 924.

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United States v. Delaware Insurance Co., Fed. Cases 14,942, p. 813.

United States v. Sheriff of Charleston, Fed. Cases 16,276, p. 1065.

United States v. Griswold, 8 Fed. 496.

Schmidtman v. Atlantic Phosphate & Oil Corp, 230 Fed. 769, p. 773.

This rule was followed by the Special Master, by the District Court and by the Circuit Court of Appeals which concludes its discussion of this feature of the case as follows:

> "We deem it to be established beyond dispute that priority claims of the United States, under Section 3466 R. S., are subordinate to the lien of a mortgage which attached before the indebtedness to the Government accrued." (Rec. p. 115.)

The fact that the present claims of the United States arise under the Transportation Act of 1920 does not differentiate the

case in any way. Neither the Federal Control Act nor the Transportation Act by their terms created any preferential right.

It is the belief of the mortgage trustees that no writ whatever should issue. Should the Court be of the opinion that the writ should be granted for any reason, however, it is respectfully urged that in any case the scope of the writ be limited so as to exclude a review of this already settled rule as to prior mortgage liens. The issuance of a writ without such limitation would be an almost insuperable bar to an early reorganization of this railroad property, which, as stated, has been in receivership since July, 1923.

II.

As to the Preferred Creditors.

The rights of creditors falling within this category, as well as the principles to which those rights are referable, have been considered by this court in a series of cases commencing with *Fosdick vs. Schall,* 99 U. S. 252 and ending with *Gregg vs. Metropolitan Trust Co.*, 197 U. S. 183. Such rights, broadly stated, are postulated of the general theory of an equitable lien on the income of the railroad during a limited period preceding a receivership, including diversions of that income during the same period either directly or indirectly, for the benefit of the mortgagees. The right thus recognized extends, upon application of the same equitable principles, to the net income of the receivership.

See

Virginia & A. Coal Co. vs. Central Ry. & Bkg. Co., 170 U. S. 355.

Southern Ry. Co. vs. Carnegie Steel Co., 176 U. S. 257.

It should be observed and emphasized that the working out of the rights and equities of this class of creditors presupposes the imposition of a lien in their favor on the mortgaged property *ahead of the mortgages.* The controversy in fact turns on determining the priority of lien as between this class and the mortgage creditors. In other words, there is, so to speak, superimposed upon the mortgage security, a prior equitable lien.

The same reasoning, therefore, which establishes the validity and priority of the mortgage liens, necessarily establishes the similar priority of the equitable liens of the preferred creditors against any asserted preferential right of the claims of the United States.

It is therefore evident that no question could arise in any case with respect to this feature, unless the proceeds realized from the foreclosure sale were more than sufficient to pay the full amount of the mortgage debt plus the amount of the preferred claims.

The equity established in favor of this class of claims is strictly limited, can be asserted only by those creditors bringing themselves within the legally prescribed conditions and is for their benefit and protection alone.

In deference to these seemingly obvious considerations, the Circuit Court of Appeals said in the instant case:

> "Holding, as they do, preferred rights under certain conditions over mortgages of record, it would seem illogical that they should be displaced by this governmental claim of priority, which, we think, is clearly inferior to the mortgage lien. These equitable rights attached and were a subsisting charge upon the assets of the railroad before the United States, in any view, was in a position to assert and enforce its claims. (Marshall, Rec. vs. People of the State of New York, 254 U. S. 380)." (Rec. p. 117.)

The grounds for invoking a review with respect to this class of creditors are as untenable as those already considered with respect to the mortgages.

The subject should similarly be excluded in considering the propriety of granting the writ here applied for.

III.

As to the General Creditors.

That no significance is ascribed to this particular feature under the circumstances of the instant case, sufficiently appears from the fact no allusion is made to unmortgaged assets. As far as this case is concerned, it is not believed that the present application would have been tendered to obtain a review of this single feature. In fact, the matter is apparently one of largely moot character.

Furthermore, and what should be decisive as far as this particular feature is concerned, it was neither involved nor passed upon under the decision here sought to be reviewed. This was indicated by the Circuit Court of Appeals in concluding its opinion as follows:

> "In as much as only holders of liens legal and equitable are before us on this appeal, and since it is conceded that the estate will not realize more than enough to discharge the mortgage indebtedness and preferred claims, we find it unnecessary to consider the effect of the decretal order upon general creditors." (Rec. p. 118.)

Conclusion.

Premised of the correctness of the matters thus suggested, it will be seen that any question of the interpretation of the Federal Control or Transportation Acts is unnecessary to the determination of the present issues. In fact, it might be said without fear of serious contradiction, that any such question is largely of academic significance in the present case. It is readily conceivable that this question may arise in other cases and under other circumstances. This, however, provides no justification for granting the present writ. Otherwise, as already stated, the effect would be to employ certiorari as a basis of eliciting advisory opinion.

As far as the abstract question of the statutes is concerned, we can add nothing to the able analysis of the Master (Rec. p. 51, et seq.) which was approved by Circuit Judge Booth (Rec. p. 88) and the reasoning of which was fully confirmed by the decision of the Circuit Court of Appeals.

For the reasons thus suggested, it is submitted that no basis is disclosed under the established rules for granting the pending petition. In any event, it is respectfully urged that the scope of a writ, if here granted, should be limited, having strict regard to the severability of the questions involved and in such wise that any review should exclude the reconsideration of long established and well settled general principles of law.

Respectfully submitted,

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SUPREME COURT OF THE UNITED STATES

OCTOBER TERM, 1929.

No. 402.

THE UNITED STATES OF AMERICA,

Petitioner,

vs.

GUARANTY TRUST COMPANY OF NEW YORK, ET AL.,

Respondents.

On Writ of Certiorari to The United States Circuit Court of Appeals for the Eighth Circuit.

Petition for Certiorari Filed September 17, 1929, Certiorari Granted October 21, 1929.

BRIEF FOR W. H. KALBACH AND CLARA SHERIFF EXECUTORS OF THE ESTATE OF H. H. SHERIFF, A PRIORITY CREDITOR, RESPONDENT.

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All of Sec. 202, Part of Sec. 207, Part of Sec. 209 and all of Sec. 210 (As amended June 5, 1920) (See Appendix) 53-60
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SUPREME COURT OF THE UNITED STATES

OCTOBER TERM, 1929.

No. 402.

THE UNITED STATES OF AMERICA,

Petitioner,

vs.

GUARANTY TRUST COMPANY OF NEW YORK, ET AL.,

On Writ of Certiorari to The United States Circuit Court of Appeals for the Eighth Circuit.

**Petition for Certiorari Filed September 17, 1929,
Certiorari Granted October 21, 1929.**

Opinion in the Court Below Will be Found: United States v. Guaranty Trust Company of New York, 33 Fed. (2d) 533.

BRIEF FOR W. H. KALBACH AND CLARA SHERIFF EXECUTORS OF THE ESTATE OF H. H. SHERIFF, A PRIORITY CREDITOR, RESPONDENT.

STATEMENT OF FACTS.

The brief for the Government is not before us, having been delayed, and it is theretofore necessary to make statement of facts, including some facts omitted in the Government's brief in the court below.

The suit, being a creditor's bill, was commenced and a receiver thereunder appointed July 26, 1923 (R., p. 81, f. 115) by the Minneapolis Steel and Machinery Company, complainant (R., p. 1, f. 1), for exceeding $15,000.00 for labor, material, etc. (R., p. 1, f. 1) against the Minneapolis & St. Louis Railroad Company, a citizen of Iowa (R., p. 13, f. 16), to which bill the defendant answered admitting the complaint and joining in the prayer for relief (R., pp. 1 and 2, ff. 2 and 3), a receiver being immediately appointed (R., p. 81, f. 115), in which suit all of the mortgage trustees were subsequently made parties defendant and thereafter, under dependent suits, the mortgage trustees brought foreclosure proceeding, all of which were consolidated with the suit under the creditor's bill (R., p. 81, f. 115).

Claims were referred to Howard S. Abbott, Esquire, Special Master, and a large number of claims were established as priority claims, among which was the claim of this respondent (R., p. 80, f. 113); that is claims as for current expense of the road within the six months rule (R., p. 81, f. 115) and the Master determined that large sums had been diverted from current income during the six months preceding the receivership to the benefit of the mortgage trustees and that such funds should be restored from the mortgaged corpus for the payment of such priority claims (R., pp. 14 and 15, ff. 17 and 18).

All of the claims here involved arose out of Federal Control during the war including the Transportation Act of 1920.

These claims are described below and consideration must be given to all of them in construing the pertinent statutes. All of them were either disallowed or allowed as general claims only without priority by the Master, by the

District Court on exceptions to the Master's report (R., pp. 69-72, ff. 85-88) and by the Circuit Court of Appeals on appeal from the decree (R., pp. 81-91, ff. 114-129). Error is assigned to only Claim No. 2700, Item 1, 3 and 4 and Claim No. 4186.

The Government claims priority over liens of mortgagees and priority claims as well as general claims under U. S. Revised Statutes, Section 3466, which provides as follows:

> "Whenever any person indebted to the United States is insolvent, or whenever the estate of any deceased debtor, in the hands of the executors or administrators, is insufficient to pay all the debts due from the deceased, the debts due to the United States shall be first satisfied; and the priority hereby established shall extend as well to cases in which a debtor, not having sufficient property to pay all his debts, makes a voluntary assignment thereof, or in which the estate and effects of an absconding, concealed, or absent debtor are attached by process of law, as to cases in which an act of bankruptcy is committed."

The priority creditors assert that the Federal Control Act of March 21, 1918, the Supplementary Act of November 19, 1919, the Transportation Act of February 28, 1920 (See Appendix for quotation of appropriate sections) are self-contained as to priority, that no governmental priority exists thereunder and that Section 3466 *supra* does not apply.

The priority creditors further contend that their liens are superior to the liens of the mortgages and that even if Section 3466 does apply, priority thereunder is inferior to all these liens.

The claims are as follows:

Item One—$1,382.00 note by the Railroad Company, dated April 1, 1921, due April 1, 1931, with interest at six per cent (6%) per annum (R., p. 4, ff. 5, 6).

This money was loaned to the Road by the Government under Section 210, Transportation Act of 1920, for the purpose of paying *a mortgage in that amount* on the part of the Road known as the "Pacific Extension Mortgage" (R., p. 4, ff. 5-8).

It was secured by collateral consisting of $2,377,000 of bonds under the Refunding and Extension Mortgage. Interest was paid on the loan to April 1, 1923 (R., p. 5, f. 6).

ITEM Two—Note for $386,190 (since reduced), dated July 1, 1921, due June 1, 1936, with interest at six per cent (6%), payable semi-annually (R., p. 5, ff. 6-8).

There is no assignment as to this Item, but its nature is necessary to the argument.

This note was given by the National Railway Service Corporation to the Government, payment guaranteed by the Road under Section 210, Transportation Act of 1920, as amended. It consisted originally of forty per cent (40%) of the purchase price of equipment, the total cost being $965,475, purchased for the Road by the National Railway Service Corporation under an equipment lease with certificates issued for the full amount of the purchase price. Forty per cent (40%) of these certificates were deferred, both as to principal and interest, as to security on the equipment. The Government took a pledge of the deferred certificates and a second lien upon $1,500,000 of the Road's refunding and extension bonds (R., pp. 5, 6, 7, ff. 6-8).

The contract was adopted by the receiver and all payments have been by him kept up (R., p. 6, f. 8). This claim was disallowed (R., p. 16, f. 20).

ITEM THREE—$625,000 note dated May 27, 1922, due March 1, 1930, to Director General, with interest at six

per cent (6%) per annum. This arose and was funded under (b) Section 207, Transportation Act of 1920, but arose under the Federal Control Act and is secured by $1,500,000 of the Road's refunding and extension bonds (R., p. 7, ff. 8, 9).

ITEM FOUR—$625,000 note dated April 1, 1923, due on demand, to Director General, with interest at six per cent (6%) per annum. This was funded under (d) Section 207, Transportation Act of 1920 as amended, but arose under the Federal Control Act and is secured by a junior lien on $1,500,000 principal of the Road's refunding and extension bonds (R., p. 7, f. 9).

The Master found that at the hearing before the Master the Government conceded that Items 3 and 4 were not entitled to priority (R., p. 15, f. 8), in this language:

> "I would also find that during the proceedings had at the time these claims were heard counsel for the Government stated in open court that the case of *Mellon, Director General v. Michigan Trust Company*, 271 U. S. 236, in which governmental priority was denied, would apply to claims No. 3268 and also to Items Nos. 3 and 5 of Claim No. 2700 for $625,000 each."

(The Master means, of course, Items Nos. 3 and 4.)

ITEM FIVE—$403,200 consisting of twelve notes, each $33,600, dated January 15, 1920, maturing annually from 1924 to 1935, inclusive, with interest at six per cent (6%).

These consist of deferred equipment trust certificates, deferred as to security out of a total issue of $1,512,000, the preferred certificate being privately held. This equipment was purchased during Federal Control and allotted to the Road under the Act of November 19, 1919, as well as the Federal Control Act (R., pp. 7 and 8, ff. 9, 10).

The equipment trust was adopted by the receiver under court order and payments have been kept up (R., p. 8, f.

10). The item was disallowed (R., pp. 16 and 17, f. 20). No error is assigned to this holding.

Due to illness of appellee's counsel while the Record was being prepared, the Record does not show the deferred and preferred certificates, but Government counsel will no doubt concede it, as they did in the court below.

Counsel will no doubt also admit that the deferred certificates held by the Government are endorsed as follows:

> "For value received and as an inducement to purchases of unstamped notes, the holder of this note has caused the same to be stamped pursuant to Article Eleventh of the Equipment Trust Agreement mentioned in the note, and, as provided in said Article Eleventh, the unstamped notes shall be payable in preference and priority to the stamped notes out of any moneys received or collected by the Trustee under said Equipment Trust Agreement upon enforcement of its rights or remedies in case of a default of the carrier."

CLAIM 4186.

$292,022.23 overpayment to the Road under estimates under guaranty provisions of Section 209, Transportation Act of 1920, but was a liability growing out of Federal Control Act. The question of amount of this claim is in litigation elsewhere, and at the hearing before the Master it was agreed that the Master should pass only upon the question of priority, the question of amount to be left open pending conclusion of other litigation (R., pp. 9 and 10, ff. 11 and 12). The claim is of course, secured as the Act requires.

The various divisional mortgages and foreclosures thereon are found by the Master (R., pp. 10 to 15, ff. 12 to 18).

Only the Refunding and Extension Mortgage need be noted here. It was given January 1, 1912, to secure an is-

sue of $75,000,000 bonds, of which $8,895,000 have been issued. It is a mortgage upon the entire Road (R., pp. 11 and 12, f. 14). The bonds here involved mature in fifty years (R., pp. 4, 5, f. 6).

POINTS AND AUTHORITIES.

I.

The Government has conceded that Items 3 and 4 of Claim No. 2700 are not entitled to priority.

Mellon, Director General v. Michigan Trust Company, 271 U. S. 236, 70 L. Ed. 924.

II.

What claims are entitled to priority.

Southern Railway Co. v. Carnegie Steel Company, 176 U. S. 257, 44 L. Ed. 458.

Fosdick v. Schall, 99 U. S. 252, 25 L. Ed. 342.

Burnham v. Bowen, 111 U. S. 776, 28 L. Ed. 596.

Virginia & Alabama Coal Co. vs. Central R. & B. Co., 170 U. S. 355, 42 L. Ed. 1068.

Texas Co. v. International & G. N. Ry. Co., 237 Fed. 921.

Moore v. Donahoo, 217 Fed. 177.

III.

The right of the priority creditors constitutes an equitable lien superior to mortgages and other claims.

United States v. Guaranty Trust Co., et al., 33 Fed. (2d) 533, 539.

Fosdick v. Schall, 99 U. S. 252, 25 L. Ed. 342.

Burnham v. Bowen, 111 U. S. 776, 28 L. Ed. 596.

Virginia & Alabama Coal Co. v. Central R. & B. Co., 170 U. S. 355, 42 L. Ed. 1068.

Southern Railway Co. v. Carnegie Steel Co., 176 U. S. 257, 44 L. Ed. 458.

Texas Co. v. International & G. N. Ry. Co., 237 Fed. 921.

Moore v. Donahoo, 217 Fed. 177.

Chicago & Alton R. R. Co. v. U. S. & Mexican Trust Co., 225 Fed. 940 (8th C. C. A.).

Illinois Trust & Savings Bank v. Daud, 105 Fed. 123 (8th C. C. A.).

IV.

Priority under Section 3466 is not over liens antecedent to the receivership.

United States v. Oklahoma, 261 U. S. 253, 67 L. Ed. 642.

Brent v. Bank of Washington, 10 Peters, 596.

V.

Priority under Section 3466 is inferior to equitable liens.

Brent v. Bank of Washington, 10 Peters, 596, 9 L. Ed. 547.

Conard v. Atlantic Insurance Co. of New York, 1 Peters 386.

Savings & Loan Society v. Multnomah County, 169 U. S. 421.

VI.

The Government claims are inferior to claims of priority creditors.

VII.

When the United States engages in private business it abandons its sovereignty and has no priority except as expressly reserved by statute.

Priority statutes to be construed strictly.

Mellon v. Michigan Trust Co., 271 U. S. 236, 239, 70 L. Ed. 924.

Davis v. Pringle, 268 U. S. 315, 318, 69 L. Ed. 974.

Davis v. Michigan Trust Co., 2 Fed. (3d) 194, 197, (6th C. C. A.).

Cook County National Bank v. United States, 17 Otto, 445, 27 L. Ed. 537.

Director General v. Kastenbaum, 263 U. S. 25, 28, 68 L. Ed. 146, 147, 44 Sup. Ct. Rep. 52.

Davis v. Pullen, 277 Fed. 650, 655, The No. 34, 11 Fed. (2d) 287.

United States v. Miller, 28 Fed. (2d) 846, 850.

Goul Coupler Co. v. U. S. Shipping Board E. F. Corp., 261 Fed. 716.

The Falcon, 19 Fed. (2d) 1009.

Standard Oil Co. v. United States, 267 U. S. 76, 45 Sup. Ct. Rep. 211, 69 L. Ed. 519.

In Re: Eastern Shore Shipbuilding Corp., 274 Fed. 893.

Salas v. United States, 234 Fed. 842.

United States v. Planters Bank of Georgia, 9 Wheat. 904.

United States v. Skinner & Eddy Corp., 28 Fed. (2d) 373.

VIII.

The United States is entitled to no greater consideration than a private citizen when it comes into court.

Hemmer v. United States, 204 Fed. 898.

Brent v. Bank of Washington, 10 Peters, 596.

United States V. Barker, 12 Wheat. 559, 6 L. Ed. 728.

United States v. Smith, 4 Otto, 214, 94 U. S. 214.

Mitchell v. United States, 9 Peters 711.

United States v. Ingate, 48 Fed. 251.

United States v. Detroit Timber & Lbr. Co., 131 Fed. 668.
United States v. Clark, 138 Fed. 294.
Mountain Copper Co. v. United States, 142 Fed. 625.

IX.

War Legislation is to be construed as a whole to find the broad purposes of congress respecting priority.

The several Acts are self-contained as to priority, and Section 3466 does not apply.

Government is estopped to claim priority under war legislation.

(A)

Canons of Construction.

Davis v. Pringle, 268 U. S. 315, 318.
Mellon v. Michigan Trust Co., 271 U. S. 236, 70 L. Ed. 924.
Cook County National Bank v. United States, 17 Otto 445, 27 L. Ed. 537.
Director General of Railroads v. Kastenbaum, 263 U. S. 25, 28, 68 L. Ed. 146.
Brent v. Bank of Washington, 10 Peters 596, 9 L. Ed. 547.

(B)

Abstract of the Statutes.

The Federal Control Act of March 21, 1918, Public Laws, 1917-1919, Vol. 40, Part 1, Page 451 (See Appendix).

The Deficiency Appropriation Act of June 30, 1919, Statutes at Large, Public Laws 1919-1921, Vol. 41, Part 1, page 34.

Act of November 19, 1919, entitled "An Act to provide for the reimbursement of the United States for motive power, etc." Public Laws 1919-1921, Vol. 41, Part 1, page 359 (See Appendix).

The Transportation Act of February 28, 1920, C. 91, 41 Stat. 456 (See Appendix).

(C)

GENERAL DISCUSSION.

ARGUMENT.

I.

The Government Has Conceded that Items 3 and 4 of Claim No. 2700 Are Not Entitled to Priority.

These two items consist of two notes for $625,000.00 each arising under the Federal Control Act and funded under Section 207 "(b)" and "(d)" respectively Transportation Act of 1920.

On the hearing before the Master, the Master finds that the Government conceded that these two claims as well as another claim arising under the Federal Control Act were not entitled to priority inasmuch as the items were governed by the case of *Mellon v. Michigan Trust Company*, 271 U. S. 236 (R., p. 15, f. 18).

In view of this concession the decision of the Circuit Court of Appeals should be affirmed in respect to these items.

II.

What Claims are Entitled to Priority.

It is a long and universally established doctrine that in liquidating or foreclosure receiverships against railroads and other public service corporations certain classes of claims are entitled to priority over mortgage liens and all other classes of claims. These claims consist of those

incurred within six months prior to the commencement of the proceedings for material, supplies and labor necessary to the continued operation of the road and to keep it a going concern and which were so incurred upon the express or implied agreement that the claims should be paid out of current income.

This priority extends to the gross prior to receivership operating current earnings (not "net earnings" as it is stated in the decision in the court below) and in addition thereto, to the net earnings of the receivership period as well as to the unmortgaged assets. If, during the six months prior to the appointment of a receiver the road has diverted moneys out of current earnings to the payment of mortgage principal or interest or to additions and betterments or to any other purpose benefiting the mortgagees the amounts so diverted must be restored for the benefit of the priority creditors from the corpus of the property if this course is necessary to pay the priority claims.

Southern Railray Co. v. Carnegie Steel Company 176 U. S. 257, 44 L. Ed. 458.

Fosdick v. Schall, 99 U. S. 252, 25 L. Ed. 342.

Burnham v. Bowen, 111 U. S. 776, 28 L. Ed. 596.

Virginia & Alabama Coal Co. v. Central R. & B. Co., 170 U. S. 355, 42 L. Ed. 1068.

Texas Co. v. International & G. N. Ry. Co., 237 Fed. 921.

Moore v. Donahoo, 217 Fed. 177.

All parties herein concede the principles above stated.

III.

The Right of the Priority Creditors Constitutes an Equitable Lien Superior to Mortgages and Other Claims.

The priority stated under the foregoing head constitutes, under the authorities, an equitable lien. The Circuit Court of Appeals so decided in this case.

United States v. Guaranty Trust Co. et al., 33 Fed. (2d) 533, 539.

The lien rests upon contract because there can be no priority claim unless it was incurred, not upon the credit of the road, but on the understanding, express or implied, that it was to be paid out of current earnings.

Fosdick v. Schall, 99 U. S. 252, 25 L. Ed. 342.

Burnham v. Bowen, 111 U. S. 776, 28 L. Ed. 596.

Virginia & Alabama Coal Co. v. Central R. & B. Co., 170 U. S. 355, 42 L. Ed. 1068.

Southern Railway Co. v. Carnegie Steel Co., 176 U. S. 257, 44 L. Ed. 458.

Texas Co. v. International & G. N. Ry. Co., 237 *Fed.* 921.

Moore v. Donahoo, 217 Fed. 177.

In Fosdick v. *Schall, supra,* the court says that such claims must be paid "which in equity and good conscience considering the character of the business are chargeable upon such earnings".

In *Burnham v. Bowen, supra,* the Court says that "consequently, it almost always happens that current income is encumbered to a greater or less extent with current debts", etc.

It will be noted that in this case upon strict foreclosure the Court ordered the road to be again seized and sold

for the payment of priority claims. This, of course, could not have happened except upon the theory that the priority claims had a lien.

In *Virginia & Alabama Coal Co. v. Central R. & B. Co., supra,* the Court says that priority claims "might have been properly allowed as a charge upon the surplus income arising during the receivership".

In *Southern Railway Co. v. Carnegie Stell Co., supra,* the Court says, in speaking of diversions of income, "the mortgage security is chargeable in equity with the restoration of any funds thus improperly diverted from their primary use".

Again the Court says that "a superior equity arises in favor of the material men as against the mortgage bond in the income arising both before and after the appointment of a receiver," etc.

Again the Court says, "the equity thus held to arise", etc.

In *Texas Co v. International & G. N. Ry. Co., supra,* the income of the receivership was impounded in equity for the benefit of the priority creditors.

In *Moore v. Donahoo, supra,* it was held that a priority creditor could enforce his equitable lien independently of proceedings in mortgage foreclosure.

Chicago & Alton R. R. Co. v. U. S. & Mexican Trust Co., 225 Fed. 940 (8th C. C. A.).

Illinois Trust & Savings Bank v. Daud, 105 Fed. 123, (8th C. C. A.).

Suffice it to say that the rights of the priority creditors constitute an equitable lien.

The lien has priority in rank over all mortgages and other liens.

IV.

Priority Under Section 3466 is not Over Liens Antecedent to the Receivership.

Judicial decisions extending over one hundred years have established that the priority under Section 3466 does not create a lien, that it becomes effective only after divestiture of the insolvent *of his property* in one of the modes provided in the statutes, and that it is subordinate to prior liens.

The principle was fully reviewed in *U. S. v. Oklahoma*, 261 U. S. 253, 67 L. Ed. 642, and *Brent v. Bank of Washington*, 10 Peters 596.

It would be superfluous for us to add to the remarkable memorandum of the Master (R. pp. 23 to 41) with citation and quotations from authorities, and especially in view of the fact that a Brief on this point will be filed in behalf of the mortgage trustees.

If the position now taken by the Government is good law, then all opinions on abstracts of title rendered during the last one hundred years have been wrong.

V.

Priority Under Section 3466 is Inferior to Equitable Liens.

That priority under Section 3466 is inferior to an equitable lien has been fully established in the Federal Supreme Court.

In the case of *Brent v. The Bank of Washington*, 10 Peters 596, 9 L. Ed. 547, the court held that the priority of the United States does not displace an equitable lien or a special equity of a claimant against property in the

hands of an insolvent at the time of divestiture within the meaning of the priority statute. In that case, a by-law of the Bank of Washington provided:

> "But all debts actually due and payable to the Bank (days of grace for payment being past) by a stockholder requesting a transfer, must be satisfied before such transfer shall be made unless the president and directors shall direct to the contrary."

The decedent, Brent, whose estate was insolvent and who was largely indebted to the Government,, owed several notes which had gone to protest at the time of his death and also owed certain debts to the bank which were not then due.

It follows, and the decision of the Court proceeds upon the theory that as to the notes not due there was no *preferred lien and that the bank had a mere equity.*

The executors brought suit against the bank to compel a transfer of decedent's stock therein discharged the lien of the bank, basing their suit in equity upon the ground that Brent was indebted to the United States and that the indebtedness took priority.

The Courts held that the action was necessarily equitable inasmuch as the executor had no means of compelling the transfer at law, and that the action, being equitable, was governed by equitable principles.. The Court says:

> "In good conscience there can be no claim more equitable than that of the bank for money lent, and if the law has placed them on the *tabula in naufragio*, it little comports with the principals of equity to take it from them merely because, by the death of Mr. Brent before the protest of the third note, the legal lien, secured by their charter, had not become consummated before the legal right of the United States had attached to priority of payment out of his estate. An individual asserting such a claim in equity against the bank, in virtue of an act of bankruptcy an execution or assignment, between the date and the protest of the note, *would be compelled to do*

> *equity* before he could enforce his legal right; and we can perceive *no reason why the United States should be exempted* from this fundamental rule of equity, subject to which, its courts administer their remedy." (Italics ours.)

The Court says again:

> "The principle of these cases covers the present in all its bearings. It is admitted that the bank have a legal right to withhold the transfer till payment of the notes protested in the lifetime of Mr. Brent; the case is equally clear in equity as to the notes indorsed by him and discounted by the bank though not protested till after his death."

See also:

Conard v. Atlantic Insurance Co. of New York, 1 Peters 386.

Savings & Loan Society v. Multnomah County, 169 U. S. 421.

VI.

The Government Claims are Inferior to Claims of Priority Creditors.

The property of the defendant railroad is subject to mortgage liens which amount, with accrued interest to approximately $56,000,000.00 (R., p. 60, ff. 73, 74). These originated prior to Federal Control. It is likewise conceded and it was found by the Master that it is improbable that the property of the railroad will sell at foreclosure sale for more than the amount of the mortgage indebtedness with accrued interest (R., p. 60, f. 74).

This being the situation it remains to inquire by what means in the light of the foregoing well established principles the Government can displace the priority creditors. The funds out of which the priority creditors must be paid, if at all, consist of funds restored out of the corpus to make

good diversions of income for the benefit of the mortgagees during the six months prior to receivership period, cash and prior to receivership operating income coming into the hands of the receiver at the time of his appointment, net income of the receiver and unmortgaged assets. The lien of the mortgages entrusts to all these items. Net income of the receiver is negligible (R., p. 60, ff. 73, 74).

We may then best illustrate the situation here by an example:

Assume a railroad receivership with a mortgage indebtedness of $40,000,000.00; assume prior to receivership diversions of income $500,000.00 and no receiver's net income; assume priority claims of $1,000,000.00; assume a sale for $40,000,000.00, the amount of the mortgage debt.

Obviously in such a case the priority creditors would receive fifty per cent or $500,000.00 and the mortgagees $39,500,000.00; but if there were no priority claims the mortgagees would receive the whole $40,000,000.00 inasmuch as their lien would extend to the entire sum.

We inquire by what reasoning the Government could, under these circumstances, take the funds which in any event would belong to the mortgagees.

But if in the same example we assume no prior to receivership diversions, a net income of the receiver of $500,000.00, sale for $39,500,000.00, the result would be the same. The mortgagees would in these circumstances take the net income under their lien, but for the equitable lien of the priority creditors.

If in either case the road were sold on foreclosure for an additional $500,000.00, the situation as to the Government would still remain unchanged. In either such case the mortgagees would, of course, be paid in full and the priority creditors fifty per cent.

The liens of the priority creditors are superior to the mortgagees. The mortgagees would take whatever the priority creditors did not take.

VII.

When the United States Engages in Private Business It Abandons Its Sovereignty and Has No Priority Except as Expressly Reserved By Statute.

Priority Statutes to be Construed Strictly.

The claims here in question arose under and out of Federal Control.

The President under statutory authority took over the railroad corporations of the country and their properties, and operated them during the war and for some time after hostilities ceased.

So far as the questions here involved are concerned, there can be no distinction between this method of handling private business and entering that field through the Shipping Board and the Emergency Fleet Corporation.

As we shall see later, congressional policy as evidenced by statutes, as well as the executive policy thereunder, was to leave the relations and rights of private citizens as little disturbed as possible during Federal Control; to invite and induce the general public to finance railroad companies in respect to the purchase of securities, the extension of credit for supplies and material, etc., as far as possible, and under the same conditions as during private operation; to furnish from the Government treasury only such necessary financial aid to the railroads as could not be procured from private sources, and for this purpose a total governmental revolving fund of $1,750,000,000 was provided.

In its relationships to the public the United States must be regarded as a *quasi* owner during Federal Control. It did what directors and stockholders of corporations often find it necessary to do, loaned money and extended credit to the corporations it was operating only so far as it could not borrow the money elsewhere for them. Such extensions of credit were virtually capital investment by the Government.

We are now met with the startling proposition that the Government could thus invite and induce the public to extend credit to governmental agencies and afterwards, when the agency becomes financially embarrassed, the Government can step in and absorb the assets in advance of private creditors, even those who are secured, for advances (similar to those that might be made by stockholders or directors) made by it only because they were necessary to keep the governmentally operated road going and because private investors refused to furnish the funds. We cannot conceive that the Federal Courts will sustain the Government in this position, unless they are compelled to do so by clear and convincing provisions in Federal Statutes. The priority of the United States must rest upon statutory provisions and not upon governmental prerogative.

In *Mellon v. Michigan Trust Co.* (271 U. S. 236, 239, 70 L. Ed. 924), the court said:

> "All agree that the rights of the Director General rests upon statutory provisions and not upon any sovereign prerogative of the United States."

Moreover, the Federal Courts in later years have tended to restrict, rather than to extend, Federal Priority. There has been a change in public pinion, which is reflected in the decisions, in respect to this priority particu-

larly due to the vast extension of governmental activities and the frequency with which the priority statutes operate unjustly to the citizen.

In *Davis v. Pringle* (268 U. S. 315, 318, 69 L. Ed. 974) the court in passing upon governmental priority under the Bankruptcy Act and the changes therein from earlier Acts says:

> "Public opinion as to the peculiar rights and preferences due to the sovereign has changed."

It was held in that case that the governmental priority was strictly limited to the priority granted by the Bankruptcy Act, and that Section 3466 did not apply.

The court having in mind this change in opinion and applying the rule of strict construction, says (p. 318):

> "We attach little value to this logical concatenation as against the direct effect of §64, taken according to the normal usages of speech. It is incredible that after the conspicuous mention of the United States in the first place at the beginning of the section and the grant of a limited priority, Congress should have intended to smuggle in a general preference by muffled words at the end. The states are mentioned in (5) before the United States, showing that their laws were primarily in mind."

In *Davis v. Michigan Trust Co.* (2 Fed. 2nd, 194, 197) (6th C. C.) the court says:

> "Judicial opinion as well as legislation is examining anew the proper privileges and immunities to be accorded the sovereign state, and in cases not clearly covered by statute or decision the correct solution is not to be found by the application of an abstract formula, but by the most careful consideration of the public needs and the practical requirements of law in the modern industrial community."
>
> "Giving due regard to the expression of congressional policy of priority, on the one hand, and of a restriction to the rights that the carrier theretofore enjoyed, on the other hand, and on a careful balancing of

> conflicting interests, we believe that, especially in the light of the policy of the present Bankruptcy Act as interpreted by the Chief Justice, *supra*, priority must be denied to the Director General in this case."

In *Cook County National Bank v. U. S.*, 17 Otto 445, 27 L. Ed. 537, it was held that the National Banking Act contained its own priority provisions and that Section 3466 did not apply.

The foregoing authorities are to the effect that a stricter rule of construction on the question of governmental priority and prerogative is necessary at this time than has heretofore been applied; that especially when the Government enters the field of private business or commercialism it surrenders its sovereignty and becomes a private citizen; that priority under these circumstances will not be granted unless compelled by the strict language of the applicable statutes; that Section 3466 will not be applied where any other conclusion is possible.

In *Melon v. Michigan Trust Co., supra* (271 U. S. 236, 239) the court said:

> "In some matters, at least, under §10, the United States stands exactly as if they were a railroad corporation operating as a common carrier. *Director Gen. v. Kastenbaum*, 263 U. S. 25, 28, 68 L. Ed. 146, 147, 44 Sup. Ct. Rep. 52. As said in *Davis v. Pullen* (C. C. A. 1st), 277 Fed. 650, 655, 'there is a certain obvious injustice in giving the United States when engaged in an industrial venture, even although under war powers, superior rights over other creditors bearing like relations to insolvents.' And we think that the indicated purpose of Congress will be best carried out by construing the relevant statutes, so far as may be, with the general intent to preserve the substantive rights of all parties concerned as they would have existed but for Federal Control."

In *The No. 34*, 11 Fed. (2d) 287 (D. C. Mass.) the court says:

> "I understand the law to be that when the United States engages in a business enterprise it is subject to the same conditions as private citizens."

In *U. S. v. Miller*, 28 Fed. 2nd, 846, 850 (8th C. C. A.) the court says:

> "* * * or when the United States steps down from its plane of sovereignty and enters the domain of business and commerce, such as operating merchant vessels by a Shipping Board, or running railroads, or going into the insurance business. When this is done, it may well be claimed that it has abandoned its sovereignty and submitted itself to the same laws that govern individuals engaged in that business. *Goul Coupler Co. v. U. S. Shipping Board E. F. Corp.* (D. C.), 261 F. 716; *The No. 34* (D. C.), 11 F. (2d) 287; *The Falcon* (D. C.), 19 F. (2d) 1009; *Standard Oil Co. v. United States*, 267 U. S. 76, 45 S. Ct. 211, 69 L. Ed. 519."

In *Gould v. U. S. Shipping Board*, 261 Fed. 716, 718 (D. C. N. Y.) Judge Hand says:

> "Moreover, it is in general highly desirable that, in entering upon industrial and commercial ventures, the governmental agencies used should, whenever it can fairly be drawn from the statutes, be subject to the same liabilities and to the same tribunals as other persons or corporations similarly employed. The immunity of the sovereign may well become a serious injustice to the citizen, if it can be claimed in the multitude of cases arising from governmental activities which are increasing so fast. At least I have no disposition to strain the point in their favor, where they fall clearly within the principle of authoritative decisions."

To the same effect are the following cases:

In re Eastern Shore Shipbuilding Corp., 274 Fed. 893.
Sales v. U. S., 234 Fed. 842.

U. S. v. Planters' Bank of Georgia, 9 Wheat. 904.
The Falcon, 19 Fed. 2d, 1009, 1013 (8), (D. C. Md.).
U. S. v. Skinner & Eddy Corp., 28 Fed. 2d, 373.

It follows from the foregoing authorities that the rule of strict construction must be followed in the present situation; that priority should not be allowed to the Government unless the applicable statutes compel such construction; that the Government stands as a private citizen in this case unless it has by statute expressly reserved its sovereign and priority status.

Weight must also be given to the circumstance that no priority such as here claimed was in contemplation of Congress when Section 3466 was enacted. This is clearly suggested by the foregoing authorities.

The modern private activities of the Government are so far beyond anything that was even remotely dreamed of at that time.

Strict construction is in these days required in the public interest, at least in respect to private ventures by the Government.

VIII.

The United States is Entitled to No Greater Consideration than a Private Citizen When it Comes Into Court.

The proposition is so well and so firmly established that when the Government becomes a party litigant in a court it is entitled to no greater consideration than the most humble private citizen. Furthermore, when it comes into equity it must do equity.

We call attention to the Master's memorandum (pages 58 to 60):

"In Equity Cases the Government Stands on Parity with Other Litigants."

and the authorities there cited.

These authorities sustain the principle:

Hemmer v. U. S., 204 Fed. 898 (8th C. C. A.).
Brent v. Bank of Washington, 10 Peters 596.
U. S. v. Barker, 12 Wheat. 559, 6 L. Ed. 728.
U. S. v. Smith, 4 Otto 214, 94 U. S. 214.
Mitchell v. U. S., 9 Peters 711.
U. S. v. Ingate, 48 Fed. 251.
U. S. v. Detroit Timber & Lbr. Co., 131 Fed. 668.
U. S. v. Clark, 138 Fed. 294.
Mountain Copper Co. v. U. S., 142 Fed. 625.

IX.

War Legislation is to Be Construed as a Whole to Find The Broad Purposes of Congress Respecting Priority.

The Several Acts Are Self-Contained as to Priority and Section 3466 Does Not Apply.

Government is Estopped to Claim Priority Under War Legislation.

(A)

Canons of Construction.

Preliminarily, in construing the war legislation these considerations are important:

(a) Manifestly, in the passage of the Transportation Act, Congress did not have in mind any change of intention or policy as to Governmental priority from that evidenced in the Federal Control Act, nor is there any such change

intended from section to section in the Transportation Act. If there had been such change Congress should and would have plainly said so and not by "muffled words at the end."

Davis v. Pringle, 268 U. S. 315, 318.

If there is no priority under the Federal Control Act it follows that there should be none under the Transportation Act unless its language compels this construction.

(b) The Federal Supreme Court has already held that the Control Act (which applies equally to the Transportation Act) must be construed on the question of priority in accordance with the broad purposes of Congress; that such purposes indicate that no priority was intended. The broad purposes are, of course, the general welfare of the people.

In *Mellon v. Michigan Trust Co.* (271 U. S. 236—70 L. Ed. 924) the question was whether the Director General had priority under Section 3466 as to indebtedness owing to him or his carrier by a private insolvent. The court said:

> "To permit the claim preference, we think would conflict with the spirit and broad purpose of the statute. These become plain enough upon consideration of the just ends which Congress had in view together with the recent policy revealed by the Banking Act in respect to priority."

We perceive no difference in the reasoning of that case when applied to the insolvency of the carrier. Surely the Government could not claim priority over a debt incurred prior to Federal Control, whether secured or unsecured, for the Act contemplated that all of these should be paid in due course.

The Government counsel conceded before the Master that the *Mellon* case, *supra,* applied to the two $625,000.00 notes.

The Master found as follows:

> "I would also find that during the proceedings had at the time these claims were heard counsel for the government stated in open court that the case of *Mellon Director General v. Michigan Trust Co.*, 271 U. S. 236 in which governmental priority was denied, would apply to Claims No. 3268 and also to Items Nos. 3 and 5 of Claim No. 2700 for $625,000.00 each" (R., p. 15, f. 18) (The Master means Items 3 and 4, R., p. 7, ff. 8, 9).

As to the two $625,000.00 notes, both arose out of Federal Control, one funded under "(b)," Section 207 Transportation Act of 1920, and one funded under "(d)," Section 207, Transportation Act of 1920. The result is that the Government concedes in principle that all Government claims against railroads which arose under the Federal Control Act are not entitled to priority under the provisions of that Act as construed in the *Mellon* case, *supra.*

(c) In construing the acts consideration should be given to the question whether the broad purposes of Congress could have been attained if these acts had specifically provided for Government priority.

(d) It must be assumed that Congress knew the decisions in the Federal Courts relating to the lien of priority claimants.

(e) The change in Federal judicial and legislative attitude as hereinbefore shown toward priority and prerogative—the new rule of strict construction at least when the Government engages in private business, must be remembered.

Mellon v. Michigan Trust Co., 271 U. S. 236, 70 L. Ed. 924.

Davis v. Pringle, 268 U. S. 315, 318, 69 L. Ed. 974.

Davis v. Michigan Trust Co., 2 Fed (2d), 194, 197.

Cook County National Bank v. United States, 17 Otto 445, 27 L. Ed. 537.

(f) The Government was engaged in private business.

Mellon v. Michigan Trust Co., 271 U. S. 236.

Director General of Railroads v. Kastenbaum, 263 U. S. 25, 28, 68 L. Ed. 146.

In the latter case, the court said:

> "The Government under Section 10 (Federal Control Act) in a case of false imprisonment, stands exactly as if it were a railway corporation operating as a common carrier." (Parenthesis ours.)

(g) The fact that these Acts contained their own provisions for security to the Government of its own selection is also of great force.

In *Cook County National Bank v. United States, supra,* the question was whether Section 3466 applied to an insolvent national bank in view of the provisions of the Banking Act.

The Supreme Court said:

> "With these provisions for security against possible loss for moneys deposited, it would seem only equitable that the Government should call for such security and, if it prove insufficient, take the position of other creditors in the distribution of the assets of the bank in case of its failure."

(h) The Government has no preference over its citizens in its own courts. It must do equity.

Brent v. Bank of Washington, 10 Peters 596, 9 L. Ed. 547.

(i) It was the manifest purpose of Congress, especially in the Transportation Act, to build up and maintain the credit of carriers from private sources. The intention was that the Government should finance only what the public ought not and refused to finance.

(j) The conditions produced by the war, the economic disturbances to carriers as well as the country in general, the impending breakdown of transportation, the circumstances under which Congress acted, must be remembered.

B.

Abstract of the Statutes.

The pertinent statutes are:

(1) The Federal Control Act of March 21, 1918, Public Laws, 1917-1919, Vol. 40, Part 1, Page 451 (See Appendix).

(2) The Deficiency Appropriation Act of June 30, 1919, Statutes at Large, Public Laws 1919-1921, Vol. 41, Part 1, Page 34.

(3) Act of November 19, 1919, entitled "An Act to provide for the reimbursement of the United States for motive power, etc." Public Laws 1919-1921, Vol. 41, Part 1, page 359 (See Appendix).

(4) The Transportation Act of February 28, 1920, C. 91, 41 Stat. 456 (See Appendix).

Federal Control Act Mar. 21, 1918:
(As amended Mar. 2, 1919)

Section 6: Revolving fund of $500,000,000, plus surplus railroad income created, to provide for expenses of Federal Control, terminals, motive power, cars, equipment.

President authorized to make additions, betterments, road extensions, provide terminals, motive power, cars, and other equipment.

May make advances from the revolving fund for these purposes and interest at such rate and on such terms as the President determines "to the end that the United

States may be fully reimbursed for any sums so advanced."

Section 7. To provide funds for maturing obligations and for other legal and proper expenditures or for reorganizing railroads in receiverships. Carriers authorized to issue bonds, notes, equipment trust certificates, stock and other forms of security, secured or unrecured, by mortgage, as the President "may first approve and consistent with the public interest."

President authorized to purchase out of the revolving fund all or any part of such securities at not exceeding par *and* to *sell* them at not less than cost when in his judgment desirable.

"Any securities so purchased shall be held by the Secretary of the Treasury who shall, under the direction by the President, represent the United States in all matters in connection therewith *in the same manner as a private holder thereof.*"

Section 10. Provides that while under Federal Control carriers are subject to the laws and liabilities as common carriers both under State and Federal law except as may be inconsistent with Federal Control Act and orders of the President.

Actions at law and suits may be brought by and against carriers and judgments rendered as now provided by law.

No defense because governmental instrumentalities.

Jurisdiction of Federal Courts and removability same as before Federal Control.

Section 12. Moneys and income from operation is property of the United States not covered into the Treasury but accounting as usual.

Disbursements without appropriation are to be made for items chargeable to operating expenses under I. C. C. rules, railway tax accruals and for such other purposes as the President may direct.

Balances are covered into the Treasury to the credit of the revolving funds. Deficits are paid out of the revolving fund.

Section 14. To continue during the war, and a limited time thereafter, subject to earlier terminatiton by the President.

Section 15. State taxes and police powers same as before Federal Control.

Section 16. Emergency legislation and not declaration of policy as to Government ownership.

Act of June 30, 1919:

Appropriates an additional $750,000,000 for revolving fund.

Act of November 19, 1919:

The title is "Act to Provide *for the Reimbursement of the United States* for Motive Power, Cars and Other Equipment ordered for Railroads and Items of Transportation under Federal Control and for Other Purposes" (Italics ours).

Provides for accepting, for these purposes, cash or shares of stock or obligations, secured or unsecured, of any corporation not a carrier organized for the purpose of owning equipment or equipment obligations, etc.

The National Railway Service Corporation was organized under this provision.

The Act specifically provides that it is an enlargement of the powers conferred by Section 6 of the Federal Control Act and so recites.

The President is fully authorized to sell obligations acquired by the Government.

Is declared emergency legislation.

Transportation Act of 1920:

Section 200. Terminates Federal Control March 1, 1920.

Section 202. Authorizes the President, upon termination of Federal Control to adjust, settle, liquidate and wind up all matters arising out of Federal Control, compensation to carriers and all questions relating to Federal Control.

Appropriates $200,000,000 to be added to the revolving fund, all of which is available for purposes of the Act.

Section 207. Provides for adjustment of debts by the President after termination of Federal Control. The items are:

(1) Additions and Betterments paid by United States.

(2) Other indebtedness to United States.

(3) The indebtedness of United States to the Carriers.

Paragraph (3) may be offset against (1) and (2) "*so far as deemed wise by the President,* but only to the extent permitted under any contract now or hereafter made • • • in respect to matters of Federal Control"; where no contract exists, then only to the extent permitted under paragraph (b) of Section 7 of the Standard Contract.

But the right of setoff must not be so exercised to prevent carrier from having enough for interest, taxes and other corporate charges and expenses referred to in paragraph (b) of Section 7 of the Standard Contract, accruing during Federal Control and dividends declared during Federal Control and accruing between the last payment and termination of Federal Control; and

Such *further working capital* equal to one-twenty-fourth of operating expenses for 1919.

Paragraph (b). Debts for additions and betterments funded for ten years or less at option of carrier, six per cent interest, terms on or before payment, security in such form and upon such terms as the President may prescribe.

Paragraph (c). Car Trust Certificates entered into shall not be refunded.

Paragraph (d). Other indebtedness due one year from termination of Federal Control; interest six per cent secured by such collateral as the President "may deem it advisable to require."

Paragraph (e). President authorized to grant extensions of time of, and to exchange all securities as may to him seem desirable.

Paragraph (f). Carriers authorized to issue Equipment Trusts to the Government for allocated equipment.

Paragraph (g). No authorization, State or Federal, required for loans.

Section 209. Provision for governmental compensation to railroads on the determined basis of earnings during the guaranty period.

The government paid to the M. & St. L. a very large sum in fulfillment of this guaranty.

(h) Advances on estimate are to be made to carriers on security for repayment to the Government of excess over amount finally found due.

Section 210. (As amended June 5, 1920).

(a) "For the purpose of enabling carriers by railroad subject to the Interstate Commerce Act *properly*

to serve the public during the transition period immediately following the termination of Federal control";

Carriers may, with two years, apply to I. C. C. for a loan from United States "to meet its maturing indebtedness or to provide itself with equipment or for other additions and betterments."

Must show property ownership, indebtedness, contract obligations, earning power and other facts relating to *propriety and expediency of granting loan* and the ability of applicant to make good the obligation.

(b) If I. C. C. finds loan necessary to enable "the applicant *properly to meet the transportation needs of the public* and that the prospective earning power of the applicant and the character and value of the security offered are *such as to furnish reasonable assurance* of the applicant's ability to repay the loan within the time fixed therefor and *to meet its other obligations* in connection with such loan" the Commission shall certify to the Secretary of the Treasury its finding of such fact, and certain other matters, including "that the prospective earning power of the applicant, together with the character and value of the security offered, furnish, in the opinion of the Commission, *reasonable assurance* of the applicant's ability to repay the loan within the time fixed therefor and *reasonable protection to the United States;* and that the applicant, in the opinion of the Commission, *is unable to provide itself with the funds necessary for the aforesaid purposes from other sources."* (Italics ours.)

(c) $300,000,000 appropriated as revolving fund for new loans.

(d) I. C. C. authorized to take advice from Federal Reserve Board.

C.

General Discussion.

The war legislation covers the question of Federal priority inferentially.

Necessarily, construction must be arried at in the light of the well known surrounding circumstances, in view of which the "broad purpose" of Congress in all of the legislation is clear and readily ascertained.

Shortly after the outbreak of the war, the President found it necessary to take control of the railroads under a very general authorization passed some years before. This was necessary, not only for transportation of troops and war materials, but in order to prevent a breakdown of carriers during the war which would have frozen the resources of the country and resulted in an economic catastrophe.

Under the pressure of the multitudinous legislation required by the war, Congress in March, of 1918, enacted the Federal Control Act.

It authorized the continuance of Federal control during the war, and for a limited time thereafter, but vested authority in the President to surrender Federal control earlier in his discretion.

It provided that the earnings of railroads during Federal control should be property of the United States, and, except for surplus earnings, should not be covered into the Treasury, but used as usual. The surplus income of the stronger roads, after certain charges thereon, was to be covered into the Treasury to the credit of the revolving fund.

A revolving fund of $500,000,000 plus surplus earnings was created, later by the act of June 30, 1919 increased to $1,250,000,000 and ultimately by the transportation

Act increased by another $500,000,000, making a total of $1,750,000,000.

Of this revolving fund the President was authorized to use $1,250,000,000 plus surplus income appropriated prior to the Transportation Act for these purposes:

(1) For the expenses of maintenance and operation.

(2) For maturing obligations, extensions, improvements, betterments, terminals, motive power, equipment, reorganization of roads in receivership and other purposes in the public interest.

The President was further authorized to cause the railroads to issue bonds, equipment trusts and all other classes of railroad securities, secured by mortgages and liens upon the carriers and unsecured as he might determine, for all these purposes including the meeting of maturing obligations, the reorganization of railroads in receivership, and to acquire for the Government out of the revolving fund any securities so issued, with the provision that the Secretary of the Treasury should hold the same for the United States "*the same as a private holder.*"

These securities the President was authorized to sell to the general public as he might determine.

The definite language of the statute in its provision that the Secretary of the Treasury should hold the same in the *same manner as a private owner* fully shows that no governmental priority was intended.

Furthermore, it was plainly the intention of Congress that the revolving fund should be used for these purposes only to the extent necessary, and that the public should be induced to extend credit, both secured and unsecured, to the railroads as far as possible, in order that undue strain upon the public treasury might be avoided. It was the intention that the Government should take and hold

only those securities *that could not be sold to the public.* It was not the intention that the Government should be responsible to private owners for securities issued by the railroads during Federal control.

Obviously, the Government could have caused a carrier to make a bond issue, secured by mortgage, could have financed initially the bond issue through the revolving fund, and might have sold half of the issue, retaining the other half, thus placing itself on a parity as to security with the private holder.

In the instant case, in both of the equipment trusts the Government did just that, with his qualification: It took equipment certificates for the initial cash payment of from twenty to forty per cent of the purchase price usually required by the manufacturer. It made these certificates those last maturing, and it made them inferior in lien, both as to principal and interest, to the remainning sixty to eighty per cent sold to the general public.

It is pertinent to here inquire what would have been the position of the Government had there been default in one of these equipment trusts, foreclosure of the security, and not enough realized to pay the preferred certificates. Supposing in such case the preferred certificate holders as well as the Government had come into this proceeding and presented their claim for deficiency. Under those circumstances could the Government, which had contracted to stand aside as to security, claim a preference over the preferred certificate holders as to the deficiencies?

It was likewise the intention of Congress that payments maturing upon all railroad securities, as well as unsecured obligations issued and incurred before Federal Control, including all taxes, should be kept up whether the carriers were solvent or insolvent, even if it had to be done out of the revolving fund.

This is exactly what was done, and any other course would have created a financial panic.

Suppose a liability for personal injury or other unsecured claim accruing before Federal control were not liquidated until after Federal control and a receivership. Could the Government now step in and say that it intended in the Federal Control Act to reserve priority over such a claim?

The intention of Congress is in fact made quite plain by the provision that the securities are to be held by the Secretary of the Treasury the same as a private holder.

In this connection we call attention to the title of the Act of November 19, 1919, which begins: "An Act to provide *for the reimbursement of the United States* for motive power, etc.," evidencing the intention of Congress to incorporate the entire provision as to how the United States was to be reimbursed.

We also direct special attention to the provisions of Section 10 of the Control Act as construed in the Mellon case, *supra.*

Obviously no Federal priority was intended under any of these enactments. Had the Act specially so provided it would have defeated the purposes of Congress, for the public would have been alarmed as to the value of railroad securities and credit.

It should furthermore be observed that these statutes contain their own provisions for security to the Government, although the taking of security was wholly a matter of discretion during the war, as it necessarily had to be.

Coming now to the Transportation Act of 1920, it is well to recall the circumstances under which Congress acted.

All will remember the debilitation of the property of carriers, rolling stock and roadbeds, during Federal Control. All will remember the strain upon carriers, their inability to meet public demands during the years 1919 and 1920.

There had also been great dislocation in the movement of traffic.

Hostilities had ceased November 11, 1918, but final peace was long in the making, and while the necessity for Federal Control had ceased, the President found himself unable with safety to the public to return the carriers to private ownership and operation. There was great danger of breakdown in transportation, with the resultant catastrophe to the country. Many of the roads were facing insolvency unless the Government should come to the rescue.

Under these circumstances Congress enacted the Transportation Act of 1920, terminating Federal Control.

It is impossible to read this legislation without coming to the conclusion that the "broad purpose" of Congress was to rehabilitate the carriers, to put them on their feet financially, to reestablish their ability to finance themselves from private sources.

Congress added $200,000,000 to the revolving fund, which was already $1,250,000,000, plus surplus and earnings, for the purpose of funding the indebtedness of carriers to the Government. It created another revolving fund of an additional $300,000,000 for the financing of new and additional loans to carriers.

It empowered the President to adjust the indebtedness of carriers to the Government, and it prohibited the Government from exercising its right of setoff in full and required that it should be made only *as deemed wise* and that the carriers should be left in funds sufficient to meet

operating expenses for a limited period, and even to pay certain dividends, and maturing interest, taxes, etc.

It required the President to fund the indebtedness of carriers to the Government at the option of the carriers, in most cases for a period of ten years, in some cases for shorter periods, and empowered the President to extend the time on all of these securities.

It required (and in this it differed from the Control Act) that these several indebtednesses should be secured as the President might determine, which meant, of course, that while the President was required to extend time, the roads were to give security such as might be available and chosen by the President.

It must be remembered that all of this indebtedness so funded originated under the Federal Control Act, and could have been represented by securities taken to the Government under the provisions of that Act.

The two $625,000 notes, and we think, also the claim for $292,022.23, Claim No. 4186, *originated directly under the Federal Control Act.*

As to these indebtednesses, it is inconceivable that if Congress did not intend governmental priority under the Control Act it could have changed its intention under the Transportation Act, and forgotten to say so. Had there been any such intention Congress would have plainly said so, not "by muffled words at the end."

The very purpose of funding this vast indebtedness was to avoid the consequences which would have ensued had the Government demanded the immediate payment. The further purpose was plainly to reestablish the private credit of the carriers, to reassure the public, and to induce the extention of such credit from private sources as far as possible.

For all of these purposes the President was authorized to utilize the vast revolving fund consisting as a whole of $1,450,000,000 and the surplus earnings.

The Government was entering the field of private investment for unsalable securities.

But this is not all. Under Section 210 of the Transportation Act (e) an additional revolving fund of $300,000,000 is provided.

It further provides (a) "for the purpose of enabling carriers by railroad subject to the Interstate Commerce Act properly to serve the public *during the transition period immediately following the termination of Federal Control*" (italics ours), the President might make loans out of this revolving fund to carriers within two years after termination of Federal Control, to enable carriers to meet their maturing indebtedness, and provide themselves with equipment, additions and betterments.

These loans were to be approved by the Interstate Commerce Commission, which in turn was authorized to take the advice of the Federal Reserve Board.

The Commission must find (b) that the loan was necessary to "enable the applicant properly to meet the transportation needs of the public"; that the earning-power of the carrier, the offered security, furnish reasonable assurance of the carrier's ability to repay at maturity, "and *to meet its other obligations* in connection with such loan." Terms could be fifteen years. There must be reasonable assurance of the applicant's ability to repay and "*reasonable protection to the United States,*" and, *most important,* the Commission must find that the carrier "*is unable to provide itself with the funds necessary for the aforesaid purposes from other sources*" (Italics ours).

In other words, the Government of the United States

in making these loans exercised not sound business judgment as an investor, *but was to take such securities as could not be privately sold* and the sale of which was necessary in the public interest. Its larger purpose was the general welfare of the public, the maintenance and reestablishment of the credit of carriers and the prevention of a panic.

In the instant case the carrier under these provisions borrowed $1,382,000 (Claim 2700, Item 1) for the purpose of meeting the then maturing underlying *Pacific Extension Mortgage* on a part of its road.

Item 2 of Claim number 2700 was likewise financed by the Government under the provisions of Section 210 of the Transportation Act (R., p. 5, ff. 6-8) for the purchase of fifteen locomotives (R., p. 6, f. 8) purchased under an Equipment Trust for the entire purchase price, preferred certificates for sixty per cent thereof being sold to the public and the remaining forty per cent deferred as to security were taken by the Government as collateral to the note of the carrier. This note represented the cash advance normally required in financing an Equipment Trust (R., pp. 5-7, ff. 6-8).

Of course this financing might have taken the form of purchase of the deferred certificates by the Government instead of taking them as pledge.

If Congress had provided in Section 210 for preference under Section 3466 would its manifest purposes have been accomplished? Would it have enabled the carrier in the instant case to serve the public during the transition period? Would it have afforded assurance to those who were expected to extend credit for labor, material, supplies, operating expenses, etc, Or would they have refused to extend such credit and thus have prevented the carrier from

properly serving the public during the transition period?

But the Government took its own security for all these obligations involved in this litigation by large pledges of the refunding and extension bonds of the carrier. The Government thereby placed itself on a par with the private bondholder, at least as to security.

These bonds became an indebtedness to the Government. Suppose the Government were enforcing the obligation under these bonds, and upon foreclosure there was a deficiency. Could the Government as holder of these bonds have come into this proceeding and claimed priority for the deficiency over the private bondholder?

The court has already held in this proceeding what nobody, not even the Government, now questions, that the interest paid on these obligations to the Government during the six months prior to receivership constitutes a diversion as against the priority creditors.

Manifestly, *no different purpose as to governmental priority runs from section to section* in the Transportation Act, and the Transportation Act is tied up with the prior Feder Control legislation so that it is inconceivable that there should have been *a change of purpose from one Act to the other without congressional mention of it.*

Conceivably, the Government investment in railroad securities could equal and even exceed the stupendous sum of $1,750,000,000.

We think it is pertinent to suggest what might have been the result to railroad securities in the great exchanges of the country and to the extension of unsecured credit to railroads, even today, if the public press should suddenly announce that this court had determined that the Government had priority for all of these war debts. The

suggestion becomes more forceful if the Government's position here should be found to be correct and it should be held that the Government had such priority even over mortgages and other liens.

Indeed, if the Government's position is well taken, the priority *would extend to mortgages issued at the dictation of the President* during Federal Control.

In the light of the statutes and their broad purposes evidenced by their language, the circumstances and conditions under which they were enacted, the position of the Government is as though it should say this to its people:

"Your Government had to take over your public carriers for the war. We found it necessary to finance them so far as you didn't. We also paid the prior debts that matured and were liquidated and presented, all in order to reassure the business world in our country.

A vast debt arose in this manner from carriers to your Government, and we told you that we would hold this the same as a private holder. We did not otherwise specially mention priority.

When the war was over and your Government wished to cease Federal Control, we found that we could not do this without further Federal aid, because carrier credit was destroyed, the carriers were run down, transportation was in danger of breaking down, and a panic would have followed without such aid.

The Government wanted its people to extend credit to the carriers, current and funded, secured and unsecured.

To induce the people to do this, and to avoid these dire consequences which we feared, your Government undertook to fund for the carriers what its people would not fund of the vast debt incurred by carriers to your Government during the war and at our dictation. We made our

own terms for repayment, picked our own security for this debt which we had told you we would hold as a private holder, and to more effectually assure you that we meant to establish and maintain the carriers in condition to be worthy of private credit during the transition period following our control, your Government said it would make new loans to carriers for their essential needs on the unsalable security that the people would not and ought not to take.

In view of these considerations and these acts of your Government, we fully expected and invited you to extend credit to carriers as usual. Except as above stated, we made no special mention of priority, but we so worded our legislation and so stated our purpose as to lead you to believe that no priority was intended.

But now in view of the fact that the Government has failed in its broad purpose and a carrier has broken down in spite of all this and gone into receivership, your Government will step in ahead of you and take the assets for repayment, to the exclusion of what we asked and expected you to loan, and we even expect to displace all your liens, if any you have.

Your Government will do this, even as to those debts which we said we would hold privately, the same as our own people."

Notwithstanding the assertions of Government counsel that equitable considerations do not enter into the construction of these statutes as well as the circumstances under which Section 3466 shall apply we direct attention to the fact that in the authorities bearing on the question, cited in this brief, both the Federal Supreme Court and the subordinate courts have laid great stress upon such considerations. They have also stressed the question of

whether a particular construction or application will injuriously affect the general welfare of the people.

Congress did not intend governmental priority as to any of these debts.

The Decision of the Circuit Court of Appeals should be affirmed.

Respectfully submitted,

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APPENDIX.

I.

Federal Control Act of March 21, 1918.

Public Laws, 1917-1919, Vol. 40, Part 1, Page 451.

"An Act to Provide for the Operation of Transportation Systems While Under Federal Control, for the Just Compensation of Their Owners, and for Other Purposes."

Sec. 6. (*As amended March* 2, 1919.) That the sum of $500,000,000 is hereby appropriated, out of any moneys in the Treasury not otherwise appropriated, which, together with any funds available from any operating income of said carriers, may be used by the President as a revolving fund for the purpose of paying the expenses of the Federal Control, and so far as necessary the amount of just compensation, and to provide terminals, motive power, cars, and other necessary equipment, such terminals, motive power, cars, and equipment to be used and accounted for as the President may direct and to be disposed of as Congress may hereafter by law provide.

The President may also make or order any carrier to make any additions, betterments, or road extensions, and to provide terminals, motive power, cars, and other equipment necessary or desirable for war purposes or in the public interest on or in connection with the property of any carrier. He may from said revolving fund advance to such carrier all or any part of the expense of such additions, betterments, or road extensions, and to provide terminals, motive power, cars, and other necessary equipment so ordered and constructed by such carrier or by the President, such advances to be charged against such carrier and to bear interest at such rate and be payable on such terms as may be determined by the President, to the

end that the United States may be fully reimbursed for any sums so advanced.

Any loss claimed by any carrier by reason of any such additions, betterments, or road extensions so ordered and constructed may be determined by agreement between the President and such carrier; failing such agreement the amount of such loss shall be ascertained as provided in section three hereof * * *.

Sec. 7. That for the purpose of providing funds requisite for maturing obligations or for other legal and proper expenditures, or for reorganizing railroads in receivership, carriers may, during the period of Federal Control, issue such bonds, notes, equipment trust certificates, stock, and other forms of securities secured or unsecured by mortgage, as the President may first approve as consistent with the public interest. The President may, out of the revolving fund created by this Act, purchase for the United States all or any part of such securities at prices not exceeding par, and may sell such securities whenever in his judgment it is desirable at prices not less than the cost thereof. Any securities so purchased shall be held by the Secretary of the Treasury, who shall, under the direction of the President, represent the United States in all matters in connection therewith in the same manner as a private holder thereof. The President shall each year as soon as practicable after January first, cause a detailed report to be submitted to the Congress of all receipts and expenditures made under this section and section six during the preceding calendar year.

Sec. 8. That the President may execute any of the powers herein and heretofore granted him with relation to Federal Control through such agencies as he may determine * * *.

Sec. 10. That carriers while under Federal Control shall be subject to all laws and liabilities as common carriers, whether arising under State or Federal Laws or at common law, except insofar as may be inconsistent with the provisions of this Act or any other Act applicable to such Federal Control or with any order of the President. Actions at law or suits in equity may be brought by and against such carriers and judgments rendered as now provided by law; and in any action at law or suit in equity against the carrier, no defense shall be made thereto upon the ground that the carrier is an instrumentality or agency of the Federal Government. Nor shall any such carrier be entitled to have transferred to a Federal Court any action heretofore or hereafter instituted by or against it, which action was not so transferable prior to the Federal Control of such carrier; and any action which has heretofore been so transferred because of such Federal Control or of any Act of Congress or official order or proclamation relating thereto shall upon motion of either party be retransferred to the court in which it was originally instituted. But no process, mesne or final, shall be levied against any property under such Federal Control * * *.

Sec. 12. That moneys and other properties derived from the operation of the carriers during Federal Control are hereby declared to be the property of the United States. Unless otherwise directed by the President, such moneys shall not be covered into the Treasury but such moneys and property shall remain in the custody of the same officers, and the accounting thereof shall be in the same manner and form as before Federal Control. Disbursements therefrom shall, without further appropriation, be made in the same manner as before Federal Control and

for such purposes as under the Interstate Commerce Commission classification of accounts in force on December twenty-seventh, nineteen hundred and seventeen, are chargeable to operating expenses or to railway tax accruals and for such other purposes in connection with Federal Control as the President may direct, except that taxes under Titles One and Two of the Act entitled "an Act to provide revenue to defray war expenses, and for other purposes," approved October third, nineteen hundred and seventeen, or any Act in addition thereto or in amendment thereof, shall be paid by the carrier out of its own funds. If Federal Control begins or ends during the tax year for which any taxes so chargeable to railway tax accruals are assessed, the taxes for such year shall be apportioned to the date of the beginning or ending of such Federal Control, and disbursements shall be made only for that portion of such taxes as is due for the part of such tax year which falls within the period of Federal Control.

At such periods as the President may direct, the books shall be closed and the balance of revenues over disbursements shall be covered into the Treasury of the United States to the credit of the revolving fund created by this Act. If such revenues are insufficient to meet such disbursements, the deficit shall be paid out of such revolving fund in such manner as the President may direct * * *.

Sec. 14. That the Federal Control of railroads and transportation systems herein and heretofore provided for shall continue for and during the period of the war and for a reasonable time thereafter, which shall not exceed one year and nine months next following the date of the proclamation by the President of the exchange of ratifications of the treaty of peace:

Provided however * * * the President may relinquish all railroads and systems of transportation under Federal Control at any time he should deem such action needful or desirable * * *.

Sec. 15. That nothing in this Act shall be construed to amend, repeal, impair, or affect the existing laws or powers of the States in relation to taxation or the lawful police regulations of the several States, except wherein such laws, powers, or regulations may affect the transportation of troops, war materials, Government supplies, or the issue of stocks and bonds.

Sec. 16. That this Act is expressly declared to be emergency legislation enacted to meet conditions growing out of war; and nothing herein is to be construed as expressing or prejudicing the future policy of the Federal Government concerning the ownership, control, or regulation of the carriers or the method or basis of the capitalization thereof.

II.

Act of November 19, 1919.

Public Laws, 1919-1921, Vol. 41, Part 1, Page 359.

AN ACT To provide for the reimbursement of the United States for motive power, cars, and other equipment ordered for railroads and systems of transportation under Federal Control, and for other purposes.

Be it enacted by the Senate and House of Representatives of the United States of America in Congress assembled, That in order to make provision for the reimbursement of the United States for the sums advanced to provide motive power, cars, and other equipment ordered

by the President for the railroads and systems of transportation now under Federal Control, herein called "carriers," pursuant to the authority conferred by the second paragraph of section 6 of the Act of March 21, 1918, the President may, upon such terms as he shall deem advisable, receive in reimbursement cash, or obligations of any carrier, or part cash and part such obligations, or in his discretion he may accept for such motive power, cars, or other equipment, cash or the shares of stock or obligations, secured or unsecured, of any corporation not a carrier organized for the purpose of owning equipment or equipment obligations, or part cash and part such shares of stock and obligations, and he may transfer to such corporation any obligations of carriers received on account of motive power, cars, or other equipment, and he may execute any instruments necessary and proper to carry out the intent of the second paragraph of section 6 of said Act of March 21, 1918, to the end that title to the motive power, cars, and other equipment so ordered by the President as aforesaid for the carriers may rest in them or their trustees or nominees.

In addition to the powers herein and heretofore conferred, the President is further authorized to dispose, in the manner and for the consideration aforesaid, of motive power, cars, and other equipment, if any, provided by him in accordance with any other provisions of said section, and of any obligations of carriers that may be received in reimbursement of the cost thereof * * *.

Sec. 3. That nothing herein contained shall be deemed to abrogate or limit the powers conferred upon the President by said Act of March 21, 1918.

Sec. 4. That the President may execute any of the powers herein granted through such agencies as he may determine.

Sec. 5. That this Act is emergency legislation, enacted to meet conditions growing out of war and to effectuate said Act of March 21, 1918.

III.

The Transportation Act of February 28, 1920.

Chap. 91, Vol. 41, Stat. L. Page 456.

"An Act to Provide for the Termination of Federal Control of Railroads and Systems of Transportation, etc."

Sec. 202. The President shall, as soon as practicable after the termination of Federal Control, adjust, settle, liquidate and wind up all matters, including compensation, and all questions and disputes of whatsoever nature, arising out of or incident to Federal Control. For these purposes and for the purpose of making the payments specified in subdivision (a) of section 201, all unexpended balances in the revolving fund created by the Federal Control Act or of the moneys appropriated by the Act entitled "An Act to supply a deficiency in the appropriation for carrying out the Act entitled 'An Act to provide for the operation of transportation systems while under Federal Control, for the just compensation of their owners, and for other purposes,' approved March 21, 1918," approved June 30, 1919, are hereby reappropriated and made available until expended; and all moneys derived from the operation of the carriers or otherwise arising out of Federal Control, and all moneys that have been or may be received in payment of the indebtedness of any carrier to the United States arising out of Federal Control, shall be and re-

main available until expended for the aforesaid purposes; and there is hereby appropriated for the aforesaid purposes, out of any money in the Treasury not otherwise appropriated, $200,000,000 in addition to the above, to be available until expended.

Sec. 207. (a) As soon as practicable after the termination of Federal Control the President shall ascertain (1) the amount of the indebtedness of each carrier to the United States, which may exist at the termination of Federal Control, incurred for additions and betterments made during Federal Control and properly chargeable to capital account; (2) the amount of indebtedness of such carrier to the United States otherwise incurred; and (3) the amount of the indebtedness of the United States to such carrier arising out of Federal Control. The amount under clause (3) may be set off against either or both of the amounts under clauses (1) and (2), so far as deemed wise by the President, but only to the extent permitted under any contract now or hereafter made between such carrier and the United States in respect to the matters of Federal Control, or, where no such contract exists, to the extent permitted under paragraph (b) of section 7 of the standard contract between the United States and the carriers relative to deductions from compensation: *Provided,* That such right of set-off shall not be so exercised as to prevent such carrier from having the sums required for interest taxes, and other corporate charges and expenses referred to in paragraph (b) of section 7 of such standard contract, accruing during Federal Control and also the sums required for dividends declared and paid during Federal Control, including, also in addition, a sum equal to that proportion of such last dividend which the period be-

tween its payment and the termination of Federal Control bears to the last regular dividend period: *And provided further,* That such right of set-off shall not be exercised unless there shall have first been paid such sums in addition as may be necessary to provide the carrier with working capital in amount not less than one twenty-fourth of its operating expenses for the calendar year 1919.

(b) Any remaining indebtedness of the carrier to the United States in respect to such additions and betterments shall, at the request of the carrier, be funded for a period of ten years from the termination of Federal Control, or a shorter period at the option of the carrier, with interest at the rate of 6 per centum per annum, payable semi-annually, subject to the right of such carrier to pay, on any interest-payment day, the whole or any part of such indebtedness. Any carrier obtaining the funding of such indebtedness as aforesaid shall give, in the discretion of the President, such security, in such form and upon such terms, as he may prescribe.

(c) If the President and the various carriers, or any of them, shall enter into an agreement for funding, through the medium of car trust certificates, or otherwise, the indebtedness of any such carrier to the United States incurred for equipment ordered for the benefit of such carrier, such indebtedness so funded shall not be refundable under the foregoing provisions.

(d) Any other indebtedness of any such carrier to the United States which may exist after the settlement of accounts between the United States and the carrier and is then due shall be evidenced by notes payable in one year from the termination of Federal Control, or a shorter period at the option of the carrier, with interest at the rate

of 6 per centum per annum, and secured by such collateral security as the President may deem it advisable to require.

(e) With respect to any bonds, notes, or other securities, acquired under the provisions of this section or of the Federal Control Act or of the Act entitled "An Act to provide for the reimbursement of the United States for motive power, cars and other equipment ordered for railroads and systems of transportation under Federal Control, and for other purposes," approved November 19, 1919, the President shall have the right to make such arrangements for extension of the time of payment or for the exchange of any of them for other securities, or partly for cash and partly for securities, as may be provided for in any agreement entered into by him or as may in his judgment seem desirable.

(f) Carriers may, by agreement with the President, issue notes or other evidences of indebtedness, secured by equipment trust agreements, for equipment purchased during Federal Control by or through the President under section 6 of the Federal Control Act, and allocated to such carriers respectively; and the filing of such equipment trust agreements with the Commission shall constitute notice thereof to all the world.

(g) A carrier may issue evidences of indebtedness pursuant to this section without the authorizing or approval of any authority, State or Federal, and without compliance with any requirement, State or Federal, as to notification * * *.

Sec. 209: This Section covers method of determining just compensation to carriers for Government use during

the war both those with and without contracts, provides for a guaranty period as a basis for such determination and contains this provision.

(h) Upon application of any carrier to the Commission, asking that during the guaranty period there may be adanced to it from time to time such sums, not in excess of the estimated amount necessary to make good the guaranty, as are necessary to enable it to meet its fixed charges and operating expenses, the Commission may certify to the Secretary of the Treasury the amount of, and times at which, such advances, if any, shall be made. The Secretary of the Treasury, on receipt of such certificate, is authorized and directed to make the advances in the amounts and at the times specified in the certificate, upon the execution by the carrier of a contract, secured in such manner as the Secretary may determine, that upon final determination of the amount of the guaranty provided for by this section such carrier will repay to the United States any amounts which it has received from such advances in excess of the guaranty, with interest at the rate of 6 per centum per annum from the time such excess was paid. There is hereby appropriated, out of any money in the Treasury not otherwise appropriated, a sum sufficient to enable the Secretary of the Treasury to make the advances referred to in this subdivision * * *.

Sec. 210. (*As amended June* 5, 1920.) (a) For the purpose of enabling carriers by railroad subject to the Interstate Commerce Act properly to serve the public during the transition period immediately following the termination of Federal Control, any such carrier may, at any time after the passage of this Act, and before the expiration of two years after the termination of Federal Control

make application to the Commission for a loan from the United States to meet its maturing indebtedness or to provide itself with equipment or other additions and betterments, setting forth the amount of the loan; the term for which it is desired; the purpose of the loan and the use to which it will be applied; the present and prospective ability of the applicant to repay the loan and meet the requirements of its obligations in that regard; the character and value of the security offered; and the extent to which the public convenience and necessity will be served. The application shall be accompanied by statements showing such facts in detail as the Commission may require with respect to the physical situation, ownership, capitalization, indebtedness, contract obligations, operation, and earning power of the applicant, together with such other facts relating to the propriety and expediency of granting the loan applied for, and the ability of the applicant to make good the obligation as the Commission may deem pertinent to the inquiry.

(b) If the Commission, after such hearing and investigation, with or without notice, as it may direct, finds that the making, in whole or in part, of the proposed loan by the United States, for one or more of the aforesaid purposes, is necessary to enable the applicant properly to meet the transportation needs of the public, and that the prospective earning power of the applicant and the character and value of the security offered are such as to furnish reasonable assurance of the applicant's ability to repay the loan within the time fixed therefor, and to meet its other obligations in connection with such loan the Commission shall certify to the Secretary of the Treasury its findings of such facts; also the amount of the loan which is to

be made; the time, not exceeding fifteen years from the making thereof, within which it is to be repaid; the terms and conditions of the loan, including the security to be given for repayment; that the prospective earning power of the applicant, together with the character and value of the security offered, furnish in the opinion of the Commission, reasonable assurance of the applicant's ability to repay the loan within the time fixed therefor and reasonable protection to the United States; and that the applicant, in the opinion of the Commission, is unable to provide itself with the funds necessary for the aforesaid purposes from other sources.

(c) Upon receipt of such certificate from the Commission the Secretary of the Treasury shall immediately, or as soon as practicable, make a loan of the amount recommended in such certificate out of any funds in the revolving fund provided for in this section and accept the security prescribed therefor by the Commission. All such loans shall bear interest at the rate of 6 per centum per annum, payable semi-annually, to the Secretary of the Treasury, and to be placed to the credit of said revolving fund. The form of obligation to be entered into shall be prescribed by the Secretary of the Treasury, but the time, not exceeding fifteen years from the making thereof, within which such loan is to be repaid. The security which is to be taken therefor and the terms and the conditions of the loan shall be in accordance with the findings and the certificate of the Commission.

(d) The Commission or the Secretary of the Treasury may call upon the Federal Reserve Board for advice and assistance with respect to any such application or loan.

(e) There is hereby appropriated out of any moneys in the Treasury not otherwise appropriated the sum of $300,000,000, which shall be used as a revolving fund for the purpose of making the loans provided for in this section, and for paying the judgments, decrees, and awards referred to in subdivision (e) of section 206.

(f) A carrier may issue evidences of indebtedness to the United States pursuant to this section without the authorization or approval of any authority, State or Federal, and without compliance with any requirement, State or Federal, as to notification.

FILE COPY

DEC 31

CHARLES ELMORE

Supreme Court of the United States

October Term, 1929.

No. 402.

UNITED STATES OF AMERICA,

Petitioner,

vs.

GUARANTY TRUST COMPANY OF NEW YORK, et al,

Respondents.

Certiorari to the United States Circuit Court of Appeals for the Eighth Circuit.

BRIEF FOR MORTGAGE TRUSTEES, RESPONDENTS.

EDWIN S. S. SUNDERLAND,
WARREN S. CARTER,
Solicitors for Guaranty Trust Company of New York,
Respondent.

HENRY V. POOR,
FREDERICK G. INGERSOLL,
Solicitors for Central Hanover Bank & Trust Company (formerly Central Union Trust Company),
Respondent.

JOSEPH M. HARTFIELD,
JESSE E. WAID,
NORTON M. CROSS,
KENNETH TAYLOR,
Solicitors for New York Trust Company,
Respondent.

JAMES H. McINTOSH,
CHARLES BUNN,
Solicitors for Bankers Trust Company,
Respondent.

EDWARD H. BLANC,
JAMES C. OTIS,
Solicitors for City Bank Farmers Trust Company (formerly The Farmers Loan and Trust Company),
Respondent.

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Certiorari to the United States Circuit Court of Appeals for the Eighth Circuit.

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OPINIONS BELOW.

The opinion of the Special Master is at R. 17. The District Court concurred in the conclusions of the Master without additional discussion (R. 72). The opinion of the Circuit Court of Appeals (R. 81) is reported at 33 Fed. (2nd) 533.

THE QUESTION.

Priority is here claimed for the United States not only over general creditors and against unmortgaged property, but over the holders of mortgage bonds as to property mortgaged many years before the claims of the United States arose. The only question which we shall discuss is whether the priority of the United States (if it has any priority) displaces such prior mortgage liens.

STATEMENT.

The seven mortgages whose liens are sought to be displaced were made by five different railroad corporations ("Minneapolis Company No. 1", "Minneapolis Company No. 3", "Minneapolis Company No. 4", Iowa Central Railway Company, Des Moines & Fort Dodge Railroad Company). (R. 10-13.) The earliest bears date February 1, 1877, the latest January 1, 1912. Each was executed on or about the date it bears, and thereupon duly recorded. Bonds were issued and are outstanding under each in large amounts (R. 10-13). In 1916 "Minneapolis Company No. 5" was created and acquired the several properties subject to the mortgages (R. 13). In 1918 this corporation was operated under federal control (R. 13), and then and thereafter it became indebted to the United States in the various amounts stated in the record (R. 4-10). This is also the corporation which is in receivership (R. 13). The Court will notice that it never owned any of the properties except subject to the mortgages; and also that the youngest mortgage preceded by nine years the oldest debt to the United States, and preceded by eleven years the insolvency and receivership which created the Government's priority.

Certain Refunding and Extension mortgage bonds (being bonds issued under the mortgage of 1912, of which Guaranty Trust Company of New York is Trustee) are held by the United States in pledge to secure certain parts of the indebtedness (R. 7). The rights of the United States as pledgee of these bonds are not disputed.

SUMMARY OF ARGUMENT.

It has been decided by this Court that the priority of the United States is subordinate to mortgage liens existing lawfully before the insolvency arises. Here the liens precede not only the insolvency but the debts to the United States themselves. The decisions of this Court are definite that such liens are not to be displaced.

ARGUMENT.

The United States have no common law priority as sovereign. The priority they claim depends entirely on Rev. Stat., Sec. 3466 (now U. S. Code, Title 31, Sec. 191). This act has been in force in substantially its present form since 1797. (The statutes, from the 1st Congress to the U. S. Code, are set out in Appendix I.) Its effect is therefore now a matter of authority. It will be convenient to refer, in their chronological order, to the decisions of this Court.

In *United States v. Fisher,* 2 Cranch 358 (1804), the Court said by Chief Justice Marshall:

> "On this subject it is to be remarked that no lien is created by this law. No bona fide transfer of property in the ordinary course of business is overreached."

The point now raised was not presented by the case.

United States v. Hooe, 3 Cranch 73 (1805). In this case F, a collector of customs, being largely in arrears in his accounts with the United States, made a deed of trust of his lands to indemnify Hooe, the surety on his official bond, against that liability and liability to be assumed as endorser of F's notes. Hooe knew about F's debt to the Government at the time the deed was made. F died. Lands conveyed under the trust deed were sold by the trustees, and the question was between Hooe and the United States as to the disposition of the proceeds. The decision was in favor of Hooe. The Court said by Chief Justice Marshall:

> "In construing the statutes on this subject, it has been stated by the court, on great deliberation, that the priority to which the United States are entitled does not partake of

the character of a lien on the property of public debtors. This distinction is always to be recollected.

* * * * *

"If a debtor of the United States, who makes a bona fide conveyance of part of his property for the security of a creditor, is within the act which gives a preference to the government, then would that preference be in the nature of a lien from the instant he became indebted; the inconvenience of which, where the debtor continued to transact business with the world, would certainly be very great."

Thelusson v. Smith, 2 Wheaton 396 (1817). In this case plaintiffs had a judgment against Crammond May 20, 1805. Two days later he made a general assignment for the benefit of creditors. The United States then recovered judgments against him, and certain of his lands were sold on execution on those judgments. The plaintiffs claimed the proceeds of those sales, asserting that their judgments were a prior lien. They had done nothing to execute their judgments. The Court held that the general floating lien of their judgments was postponed to the executed sale by the United States. The Court, however, said:

"The United States are to be first satisfied; but then it must be out of the debtor's estate. If, therefore, before the right of preference has accrued to the United States, the debtor has made a bona fide conveyance of his estate to a third person, or has mortgaged the same to secure a debt, or if his property has been seized under a *fi. fa.*, the property is divested out of the debtor, and cannot be made liable to the United States."

Conard v. Atlantic Insurance Co., 1 Peters 386 (1828). In this case the conflict was between the Insurance Company, a creditor secured by respondentia bond, and the United States as judgment and execution creditor. The decision was in

favor of the private creditor. The nature of the Government's priority was discussed at length by Mr. Justice Story. He said:

"Then, again, it is contended on behalf of the United States that the priority thus created by law, if it be not of itself a lien, is still superior to any lien, and even to an actual mortgage, on the personal property of the debtor.

"It is admitted that where any absolute conveyance is made, the property passes so as to defeat the priority, but it is said that a lien has been decided to have no such effect; and that, in the eye of a court of equity, a mortgage is but a lien for a debt. *Thelluson v. Smith,* 2 W. 396, has been mainly relied on in support of this doctrine. That case has been greatly misunderstood at the bar, and will require a particular explanation. But the language of the learned Judge who delivered the opinion of the court in that case is conclusive on the point of a mortgage: 'The United States,' said he, 'are to be first satisfied; but then it must be out of the debtor's estate. If, therefore, before the right of preference has accrued to the United States, the debtor has made a bona fide conveyance of his estate to a third person, or has mortgaged the same to secure a debt; or if his property has been seized under a *fieri facias,* the property is divested out of the debtor, and cannot be made liable to the United States.' The same doctrine may be deduced from the case of *United States v. Fisher,* 2 C. 358, where the court declared that 'no bona fide transfer of property in the ordinary course of business, is overreached by the statutes'; and 'that a mortgage is a conveyance of property, and passes it conditionally to the mortgagee'. If so plain a proposition required any authority to support it, it is clearly maintained in *United States v. Hooe,* 3 C. 73.

* * * * *

But it has never yet been decided, by this court, that the priority of the United States will divest a specific lien, attached to a thing, whether it be accompanied by possession or not. * * * And before such decision is made, it will deserve very grave deliberation, and a marked atten-

tion to what fell from the court, in *Nathan v. Giles,* 5 Taunt. 558, 574. At present it is wholly unnecessary to decide it, for reasons which will hereafter appear."

Field v. United States, 9 Peters 182 (1835). This was a suit by the United States against the "syndics" (assignees) of an insolvent debtor. The assignees had sold the debtor's property, and distributed a portion of the proceeds. Some of the property was subject to mortgages. The Court said by Chief Justice Marshall:

> "There is no doubt that the mortgages upon particular estates sold, must be first paid out of the proceeds of the sales of those estates."

Brent v. Bank of Washington, 10 Peters 596 (1836). In this case Robert Brent, a stockholder of the Bank of Washington, died insolvent, indebted both to the bank and to the United States. The charter of the bank gave it a lien on its shares by prohibiting their transfer until debts due the bank were paid. The suit was to enforce a transfer of the shares, for the benefit of the United States, without satisfaction of the claims due to the bank. This Court held for the bank, and said:

> "This preference is in the appropriation of the debtor's estate; so that if, before it has attached, the debtor has conveyed or mortgaged his property, or it has been transferred in the ordinary course of business, neither are overreached by the statutes, 1 Pet. 440; and it has never been decided that it affects any lien, general or specific, existing when the event took place which gave the United States a claim of priority."

In *Savings and Loan Society v. Multnomah County,* 169 U. S. 421, the court held that a mortgage was an interest in real estate and taxable at the situs of the land. In that connection it was said:

> "This court has always held that a mortgage of real estate, made in good faith by a debtor to secure a private debt, is a conveyance of such an interest in the land, as will defeat the priority given to the United States by act of Congress in the distribution of the debtor's estate. *United States v. Hooe,* 3 Cranch 73; *Thelusson v. Smith,* 2 Wheat. 396, 426; *Conard v. Atlantic Ins. Co.,* 1 Pet. 386, 441."

In *United States v. Oklahoma,* 261 U. S. 253, at 259, the Court said:

> "The claim of the United States to the asserted priority rests exclusively upon the statute. No lien is created by it. It does not overreach or supersede any bona fide transfer of property in the ordinary course of business. It establishes priority which is limited to the particular state of things specified."

In *Spokane County v. United States,* 279 U. S. 80, the conflict was between United States and State taxes. The Supreme Court of Washington had held that what it described as the "inchoate tax lien right" of the State had never been perfected so as to be a lien on specific property. This Court therefore said:

> "Whatever might have been the effect of more completed procedure in the perfecting of the liens under the law of the state, upon the priority of the United States herein, the attitude of the state court relieves us of consideration of it."

We attach to this brief, as appendix II, reference to the decisions of the inferior Federal Courts, and to certain opinions of the Attorney General.

It is suggested that some or all of the foregoing statements are mere dictum. It may be admitted that in certain of the cases other grounds were present for decision, and were relied on by the Court. But the Court also regarded as important

the principles announced in the foregoing quotations. And it is impossible to be mistaken as to the course of the decisions. In every single case where a private creditor appeared holding a specific lien antedating the insolvency, the decision was in favor of the private creditor. All kinds of liens have been considered and all attaching to specific property have been protected. The principle that private lenders may safely make advances on usual securities without seeing those securities displaced by general obligations to the government, has become a rule of property, on which vast sums have been advanced to all kinds of business corporations.

Many of the cases were much stronger for the Government than this. In the *Hooe* case, for instance, the debt to the Government existed and was known to the private creditor when the security was given. In this case the debtor of the Government did not even own the property (indeed was not even in existence) when the mortgages were made.

It is suggested that the Government's advances saved the property in 1921 and thereby benefited mortgagees. That suggestion would no doubt be important if the property and liens were maritime. But on land the prior mortgagee is prior until he himself consents to subordinate his mortgage, or until a court of equity, conducting a receivership, orders the creation of a superior lien. These loans and obligations to the United States were created not by the mortgagees or with their participation, nor by any court, but by arrangements between the debtor and the Government alone. It is not possible by such an arrangement, however proper and wise for both the parties to it, to divest third persons of their existing security. Nor is it clear that benefit to the mortgagees exists. No doubt the Government advances were of assistance to the railroad company, and postponed its receivership and default on its mortgages. But it is by no means clear that the holder of a mort-

gage on a failing enterprise is benefited by postponement of the date on which he is permitted to foreclose.

Respectfully submitted,

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APPENDIX I.

The following are the acts, from the beginning of the Government, dealing with the subject now covered by Revised Statutes, Section 3466.

I.

First Congress, Sess. II, Chap. 35, approved August 4, 1790, I Statutes at Large, 169:

"An Act to provide more effectually for the collection of duties imposed by law on goods, wares and merchandise imported into the United States, and on the tonnage of ships or vessels.

* * * * *

Section 45. And be it further enacted, that where any bond for the payment of duties shall not be satisfied on the day it became due, the collector shall forthwith cause a prosecution to be commenced for the recovery of the money thereon, by action or suit at law, in the proper court having cognizance thereof; and in all cases of insolvency, or where any estate in the hands of executors or administrators shall be insufficient to pay all the debts due from the deceased, the debt due to the United States, on any such bond, shall be first satisfied."

II.

Second Congress, Sess. I, Ch. 27, approved May 2, 1792, I Statutes at Large 263.

"An act for raising a further sum of money for the protection of the frontiers, and for other purposes therein mentioned."

* * * * *

Section 18. "AND BE IT ENACTED AND DECLARED, That if the principal in any bond which shall be given to the United States, for duties on goods, wares, and merchandise imported, shall be insolvent, or if such principal being dead, his or her estate and effects, which shall have come to the hands of his or her executors or administrators, shall be insufficient for the payment of his or her debts, and if, in either of the said cases, any surety in any said bond, or the executors and administrators of such surety, shall pay to the United States the monies thereupon due, such surety, his or her executors or administrators, shall have and enjoy the like advantage, priority and preference, for the recovery and receipt of the said monies out of the estate and effects of such insolvent or deceased principal, as are reserved and secured to the United States, by the forty-fourth (should be the 45th) section of the Act, entitled 'An Act to provide more effectually for the collection of duties imposed by law on goods, wares and merchandise imported into the United States, and on the tonnage of ships or vessels', and shall and may bring and maintain a suit upon the said bond, in law or equity, in his, her or their own name or names, for the recovery of the monies which shall have been paid thereupon. AND IT IS FURTHER DECLARED, that the cases of insolvency in the said forty-fourth section mentioned, shall be deemed to extend as well to cases in which a debtor, not having sufficient property to pay all his or her debts, shall have made a voluntary assignment thereof, for the benefit of his or her creditors, or in which the estate and effects of an absconding, concealed or absent debtor shall have been attached by process of law, as to cases, in which an act of legal bankruptcy shall have been committed."

III.

Fourth Congress, Session II, Chapter 20, approved March 3, 1797, I Statutes at Large, 515:

"An Act to provide more effectually for the settlement of accounts between the United States and receivers of public money.

* * * * *

Section 5. And be it further enacted, that where any revenue officer, or other person hereafter becoming indebted to the United States, by bond or otherwise, shall become insolvent, or where the estate of any deceased debtor, in the hands of executors or administrators, shall be insufficient to pay all the debts due from the deceased, the debt due to the United States shall be first satisfied; and the priority hereby established shall be deemed to extend, as well to cases in which a debtotr, not having sufficient property to pay all his debts, shall make a voluntary assignment thereof, or in which the estate and effects of an absconding, concealed, or absent debtor, shall be attached by process of law, as to cases in which an act of legal bankruptcy shall be committed."

IV.

Fifth Congress, Sess. III, Ch. 22, approved March 2, 1799, I Statutes at Large p. 676.

"An Act to regulate the collection of duties on imports and tonnage."

* * * * *

Section 65. "And Be It Further Enacted, That where any bond for the payment of duties shall not be satisfied on the day it may become due, the collector shall, forthwith and without delay, cause a prosecution to be commenced for the recovery of the money thereon by action or suit at law, in the proper court having cognizance thereof; and in all cases of insolvency, or where any estate in the

hands of the executors, administrators or assignees, shall be insufficient to pay all the debts due from the deceased, the debt or debts due to the United States, on any such bond or bonds, shall be first satisfied; and any executor, administrator, or assignees, or other person, who shall pay any debt due by the person or estate from whom, or for which, they are acting, previous to the debt or debts due to the United States from such person or estate being first duly satisfied and paid, shall become answerable in their own person and estate, for the debt or debts so due to the United States, or so much thereof as may remain due and unpaid; and actions or suits at law may be commenced against them for the recovery of the said debt or debts, or so much thereof as may remain due and unpaid, in the proper court having cognizance thereof; PROVIDED, that in all cases in which suits or prosecutions shall be commenced for the recovery of duties or pecuniary penalties prescribed by the laws of the United States, the person or persons against whom process may be issued, shall and may be held to special bail, subject to the rules and regulations which prevail in civil suits in which special bail is required: AND PROVIDED ALSO, that if the principal in any bond, which shall be given to the United States for duties on goods, wares or merchandise imported, or other penalty, either by himself his factor, agent, or other person for him, shall be insolvent, or if such principal being deceased, his, or her estate and effects, which shall come to the hands of his or her executors, administrators or assignees, shall be insufficient for the payment of his or her debts, and if in either of the said cases, any surety on the said bond or bonds, or the executors, administrators or assignees of such surety shall pay to the United States the money due upon such bond or bonds, such surety, his or her executors, administrators or assignees, shall have and enjoy the like advantage, priority or preference for the recovery and receipt of the said monies out of the estate and effects of such insolvent, or deceased principal, as are reserved and se-

cured to the United States; and shall and may bring and maintain a suit or suits upon the said bond or bonds in law or equity, in his, her, or their own name or names, for the recovery of all monies paid thereon. And the cases of insolvency mentioned in this section, shall be deemed to extend as well to cases in which a debtor, not having sufficient property to pay all his or her debts, shall have made a voluntary assignment thereof, for the benefit of his or her creditors, or in which the estate and effects of an absconding, concealed or absent debtor, shall have been attached by process of law, as to cases in which an act of legal bankruptcy shall have been committed. And where suit shall be instituted on any bond for the recovery of duties due to the United States, it shall be the duty of the court, where the same may be pending, to grant judgment at the return term, on motion, unless the defendant shall, in open court, the United States Attorney being present, make oath or affirmation that an error has been committed in the liquidation of the duties demanded upon such bond, specifying the errors alleged to have been committed, and that the same have been notified in writing to the Collector of the district, prior to the commencement of the return term aforesaid: whereupon, if the court be satisfied, that a continuance until the next succeeding term, is necessary for the attainment of justice, and not otherwise, a continuance may be granted until next succeeding term and no longer. And on all bonds upon which suits shall be commenced, an interest shall be allowed at the rate of six per cent per annum, from the time when said bonds become due, until the payment thereof."

V.

Revised Statutes, 1873-4.

Title XXXVI. Debts Due By Or To the United States.

Section 3466. "Whenever any person indebted to the United States is insolvent, or whenever the estate of any deceased debtor, in the hands of the executors or administrators, is insufficient to pay all the debts due from the deceased, the debts due to the United States shall be first satisfied; and the priority hereby established shall extend as well to cases in which a debtor, not having sufficient property to pay all his debts, makes a voluntary assignment thereof, or in which the estate and effects of an absconding, concealed, or absent debtor are attached by process of law, as to cases in which an act of bankruptcy is committed."

VI.

United States Code, Title 31, Section 191.

(This is identical with Revised Statutes, Section 3466.)

APPENDIX II.

DECISIONS OF INFERIOR FEDERAL COURTS, AND OPINIONS OF THE ATTORNEY GENERAL.

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(1) *Inferior Federal Courts.*

In *United States v. Sheriff of Charleston*, Fed. Cas No. 16,276 (1803), the United States and a private person each had judgment against the collector of the port and levied execution on the same property. The private judgment and levy were first in time. The suit was to enjoin a sale under the private levy. The Court sustained a demurrer to the bill and said:

> "I cannot find that these acts do in any manner comprehend the present case. There is not a syllable in either of them that can be fairly construed to divest a prior legal lien."

In *United States v. Delaware Insurance Co.*, Fed. Case No. 14,942 (1823), the defendant loaned money to a merchant in the China trade, secured by respondentia and bills of lading. The merchant failed, being indebted to the United States for customs duties, and the controversy was as to the proceeds of the goods covered by the bills of lading. Mr. Justice Washington directed a verdict for defendant.

In *United States v. Cutts*, Fed. Case No. 14,912 (1832), an insolvent decedent had before his death endorsed to and pledged with a lender, as security, certain five per cent stock of the United States. The transfer of the stock had never been recorded on the public books. Mr. Justice Story stated the question to be:

> "Whether the instrument under which Schaefe claims a right to the stock in controversy, and the deposit of the certificate with him, were a sufficient equitable assignment of the stock, or gave a sufficient lien thereon to defeat the priority of the United States,"

and decided that they did.

In *United States v. Canal Bank*, Fed. Case No. 14,715 (1844), the United States and a private creditor had both recovered judgments against the same debtor, and had levied attachments on the same property. The attachment of the private creditor was first in time. Mr. Justice Story held it superior to that of the United States.

In *United States v. Duncan*, Fed. Case No. 15,003 (1850), the Court said:

> "It has been uniformly held in all the cases that the priority of the United States does not disturb any specific lien, nor the perfected lien of a judgment, that is it does not supersede a mortgage on land, nor a judgment made perfect by the issue of an execution and a levy on land. *Thelluson v. Smith*, 2 Wheat. (15 U. S.) 396; *Conard v. Atlantic Ins. Co.*, 1 Pet. (26 U. S.) 386."

In *United States v. Lewis*, Fed. Case No. 15,595 (1875), the Court said (by Mr. Justice Strong):

> "True, the priority of the United States does not override any liens upon the debtor's property which existed before the event occurred which gives the statutory priority, that is, before the insolvency. *Conard v. Atlantic Ins. Co.*, 1 Pet (26 U. S.) 438; *Brent v. Bank of Washington*, 10 Pet. (35 U. S.) 596. The reason for this is obvious. The claim of the government extends only to that which was the property of the debtor when he became insolvent, and his property is only that, in substance, which remains

after the satisfaction of liens upon it. His power of disposition extends no farther. The lien is paramount to his right."

In *Cottrell v. Pierson,* 12 Fed. 805 (1881), the Court said:

"It may now be regarded as settled that the priority of the United States, given by these statutes, 'does not overrule any liens upon the debtor's property which existed befor the event occurred which gives the statutory priority; that is, before the insolvency.' *U. S. v. Lewis,* 13 N. B. R. 38; *Conard v. Ins. Co.,* 1 Pet. 438; *Brent v. The Bank,* 10 Pet. 596."

(2) *Opinions of the Attorney General.*

Priority of United States over other Creditors, 1 Op. Atty. Gen. 616 (1823). In this opinion the Attorney General (Wm. Wirt) advised that a lien on an insurance policy for a premium advanced was not preferred over a debt to the United States. The opinion proceeds on two grounds: (1) The authority of Thelluson v. Smith; (2) the fact that the private creditor had voluntarily parted with possession of the policy.

Discharge of Insolvent Debtors, 5 Op. Atty. Gen. 762 (1831). This opinion is concerned with the construction of an "Act for the relief of certain insolvent debtors of the United States", the question being whether certain creditors who had, before legal insolvency but when they were unable to pay their current debts, given security to private creditors, should be denied the benefit of discharge of their debts to the United States under that act. The Attorney General (R. B. Taney) held that they should be denied such relief, because by giving such security they had intentionally and effectively prevented the priority to which the United States would otherwise have been entitled from attaching and had therefore "fraudulently deprived the

United States of their legal priority" within the language of the act.

Case of Jacob Richardson, 9 Op. Atty. Gen. 28 (1857). Richardson, a collector, died insolvent and in debt to the United States. Before his death, but after his default, he mortgaged land to his sureties for their indemnity. The Attorney General (J. S. Black) held this mortgage not overridden by the United States' priority. (This opinion is set out in full in the Master's report, R. 35).

(3) *Other Authorities.*

Blair, The Priority of the United States in Equity Receiverships, 39 Harvard Law Review 1, 22.

Rogge, The Differences in the Priority of the United States in Bankruptcy and in Equity Receiverships, 43 Harvard Law Review 251, 264.

SUPREME COURT OF THE UNITED STATES.

No. 402. October Term, 1929.

United States, Petitioner, *vs.* Guaranty Trust Company of New York, et al. } On Certiorari to the United States Circuit Court of Appeals for the Eighth Circuit.

[February 24, 1930.]

Mr. Justice Brandeis delivered the opinion of the Court.

On July 26, 1923, the federal court for Minnesota appointed a receiver of The Minneapolis & St. Louis Railroad upon a creditor's bill, which was later consolidated with suits to foreclose its mortgages. The usual order issued for proof of claims. The United States presented four claims arising under Title II of Transportation Act, 1920, February 28, c. 91, 41 Stat. 456, 457-469. As to each claim it asserted that, by § 3466 of the Revised Statutes, U. S. C., Tit. 31, § 191, it was entitled to preference and priority over the claims of all other creditors, secured or unsecured. Opposing creditors conceded that the Railroad was insolvent within the meaning of § 3466. *United States* v. *Butterworth-Judson Corporation*, 269 U. S. 504. The insistence that the United States did not have priority was rested, among other grounds, upon the origin and character of its claims. The master and the District Court denied the United States priority over any creditor. The Circuit Court of Appeals affirmed that decree, but limited its decision to a denial of priority over secured creditors and those whose claims were preferred by local law or by the rule of *Fosdick* v. *Schall*, 99 U. S. 235. It did not consider the relation of the Government's claims to those of general creditors, because it concluded that the estate would not realize more than enough to satisfy the secured and preferred creditors and because general creditors were not parties to the appeal. 33 F. (2d) 533. A writ of certiorari was granted. 280 U. S. —.

Title II of Transportation Act, 1920, comprising §§ 200 through 211, is headed "Termination of Federal Control". Section 207

(pp. 462-3), provides that the "indebtedness of each carrier to the United States, which may exist at the termination of Federal control, incurred for additions and betterments made during Federal control and properly chargeable to capital account . . . shall, at the request of the carrier, be funded for a period of ten years from the termination of Federal control, or a shorter period at the option of the carrier"; and also that any other then existing indebtedness to the United States should be evidenced by notes payable in one year from the termination of Federal control, or less at the option of the carrier. For both classes of debts, the carrier is to pay interest at the rate of 6 per cent per annum and, in the discretion of the President, to give such security as he may require.[1] Two of the claims of the United States here in question are based on promissory notes made pursuant to this section. Each of the two notes is in the amount of $625,000. One is dated May 27, 1922, and is due March 1, 1930, ten years after termination of Federal control; the other is dated April 1, 1923, and is payable on demand. Each bears interest at 6 per cent, payable semi-annually, and is secured by a deposit of the Company's Series A 50-year refunding and extension mortgage bonds, dated January 1, 1912.

The third claim arose under § 209. That section (at p. 466) authorizes the Secretary of the Treasury, upon certification by the Interstate Commerce Commission, to advance to any carrier, on account of the guaranty of operating income there provided for the six months following the termination of Federal control, sums "necessary to enable it to meet its fixed charges and operating expenses"—the advances to be "secured in such manner as the Secretary may determine"; and provides for repayment by the carrier of any amount proved to have been paid in excess of the guaranty.

[1]See Report of Director General for the period December 31, 1921, 67th Cong., 2d Sess., H. R. Doc. 180, p. 12: "The total amount expended by the Railroad Administration for such additions and betterments aggregates $1,144,681,582.39. The Transportation Act of 1920 in Section 207, anticipated that the carriers might not be able to pay out of the compensation and other sums due them from the Government all the sums due the Government on account of capital expenditure, and therefore provided that only so much of the indebtedness due from the United States to the carriers should be offset by the indebtedness due the United States from the carriers 'as deemed wise by the President,' and further provided that any funding obtained by the carriers should be granted only upon their giving security in such form and upon such terms as the President may prescribe . . ."

Compare *Great Northern Ry.* v. *United States,* 277 U. S. 172. The amount claimed by the United States under this section is $292,022.23, which sum the Interstate Commerce Commission certified had been advanced in excess of the guaranteed amount. See *Guaranty Settlement With Minneapolis & St. Louis R. R.,* 86 I. C. C. 691.

The fourth claim arose under § 210, (p. 468). "For the purpose of enabling carriers . . . properly to serve the public during the transition period immediately following the termination of Federal control", that section, as amended by Act of June 5, 1920, c. 235, § 5, 41 Stat. 874, 946, authorizes loans by the Government to carriers, if a loan is required by a carrier "to meet its maturing indebtedness, or to provide itself with equipment or other additions and betterments". The loans are to be made only on security; for a period not in excess of fifteen years; and if application therefor is made to the Interstate Commerce Commission within two years from the termination of Federal control. And no loan can be made, unless the Commission first finds and certifies that the loan is necessary to enable the applicant to meet the transportation needs of the public; "that the prospective earning power of the applicant and the character and value of the security offered are such as to furnish reasonable assurance of the applicant's ability to repay the loan within the time fixed therefor, and to meet its other obligations in connection with such loan . . . and that the applicant . . . is unable to provide itself with the funds necessary for the aforesaid purposes from other sources." The claim under this section is on a promissory note for $1,382,000 dated April 1, 1921, which was given in consideration of a loan of that amount, made to enable the Company to pay a maturing issue of its outstanding mortgage bonds. The note is payable in ten years, with interest semi-annually at the rate of 6 per cent, and is secured by a deposit of the Company's Series A, 50-year refunding and extension mortgage bonds, dated January 1, 1912. See *Loan to Minneapolis & St. Louis R. R.,* 67 I. C. C. 321, 323; *Bonds of Minneapolis & St. Louis R. R., ibid.,* 362.

The alleged priority of the United States under § 3466 over mortgages and over unsecured claims preferred by local law (compare *Spokane County* v. *United States,* 279 U. S. 80) or by the rule of *Fosdick* v. *Schall, supra,* was discussed in the lower courts and was argued by counsel before this Court. But we have no occasion to consider these questions. For, we are of opinion that it was the

purpose of Congress that § 3466 should not apply to any indebtedness of the railroads to the United States arising under §§ 207, 209 or 210 of Transportation Act, 1920.

During Federal control, the Government had been obliged to provide most of the new capital required for equipment, improvements and extensions,[2] and some of the funds needed to meet current interest and dividend payments.[3] The Federal Control Act, March 21, 1918, c. 25, § 6, 40 Stat. 451, 455, appropriated $500,000,000 "to be used by the President as a revolving fund for the purpose," among other things, of providing "terminals, motive power, cars, and other necessary equipment." The Act of June 30, 1919, c. 5, 41 Stat. 34, appropriated $750,000,000 more. The Transportation Act, 1920, §§ 202 and 210, made a similar provision in appropriating for the purposes of Title II, $500,000,000; in addition to the sums otherwise available and in addition to the general appropriations made in §§ 204 (g) and 209 (g), (h) and (i).

These appropriations were made in order to meet a pressing need. At the time of the passage of Transportation Act, 1920, most of the railroads of the United States lacked funds for necessary improvements, equipment, and expansion of facilities. Some of the carriers needed funds, also, to meet maturing obligations. The credit of many carriers was seriously impaired. There was a general reluctance among investors to purchase new railroad securities even of the strongest railroads. Congress deemed it important

[2]See note 1, *supra*. Of the amount expended for these purposes during Federal control only $140,000,000, approximately, was paid through funds raised by the companies. Report of the Director General to the President for fourteen months ended March 1, 1920 (Revised Edition, 1921), p. 31.

[3]Mainly for this purpose, the Director General advanced to the carriers between the commencement of Federal control and August 1, 1918, $203,714,050. Report of the Director General for period ending July 31, 1918, pp. 23-24. In the statement of the President accompanying his Proclamation of December 26, 1917, on taking possession of the railroads, he had stated: " . . . the financial interests of the Government and the financial interests of the railways must be brought under a common direction. . . . Investors in railway securities may rest assured that their rights and interests will be as scrupulously looked after by the Government as they could be by the directors of the several railway systems." U. S. R. R. Administration Bulletin No. 4 (Revised 1919), p. 10. See also Report of Senate Committee, November 10, 1919, No. 304, 66th Cong., 1st Sess., pp. 3-12; Report of House Committee, November 10, 1919, No. 456, 66th Cong., 1st Sess., pp. 12-13; Walker D. Hines, "War History of American Railroads", pp. 120-140.

to preserve for the nation substantially the whole existing transportation system. Compare *New England Divisions Case,* 261 U. S. 184, 190. In order to accomplish this, it was thought necessary that the United States should, to a certain extent, finance the carriers until it would become possible to restore their credit, by increase of rates or otherwise. The provisions of Title II of Transportation Act, 1920, were framed to that end. Through them, the financial aid which had been given during Federal control was to be extended for a further period.

To have given priority to debts due the United States pursuant to Title II, would have defeated the purpose of Congress. It not only would have prevented the reestablishment of railroad credit among bankers and investors, but it would even have seriously impaired the market value of outstanding railroad securities. It would have deprived the carriers of the credit commonly enjoyed from supplymen and others; would have seriously embarrassed the carriers in their daily operations; and would have made necessary a great enlargement of their working capital. The provision for loans under § 210 would have been frustrated. For, carriers could ill afford voluntarily to contract new debts thereunder which would displace, *pro tanto,* their existing bonded indebtedness. The entire spirit of the Act makes clear the purpose that the rule leading to such consequences should not be applied.

Moreover, Congress evidenced unmistakably its purpose to rely, for obtaining payment of the Government's advances, upon means other than the priority provided for by § 3466. Under all of the sections, the giving of adequate security was either required or left to the discretion of the President. Under § 210 no advance could be made, unless the Interstate Commerce Commission was satisfied that the earning power of the carrier and the security given furnished reasonable assurance that the loan would be repaid and all obligations in connection therewith would be performed.[4] The interest rate required is much greater than that which ordinarily accompanies even a business loan carrying such assurance of repayment as would have resulted from an application of the priority rule. Thus, both the general purposes of Title II and its specific

[4]In some instances the Commission has authorized security which expressly provided only deferred liens. Loan to Chicago, Rock Island & Pac. Ry., 67 I. C. C. 569; Loan to Minneapolis & St. Louis R. R., *ibid.* 580; Equipment Notes of Minneapolis & St. Louis R. R., 70 I. C. C. 67.

provisions make it clear that Congress intended to exclude the indebtedness so arising from the scope of § 3466 of the Revised Statutes, just as under the Federal Control Act it had excluded therefrom claims incident to current operation of the railroads. *Mellon* v. *Michigan Trust Co.*, 271 U. S. 236, 240.

Affirmed.

A true copy.

Test:

Clerk, Supreme Court, U. S.